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TAX ISSUES AFFECTING THE TIMBER INDUSTRY

HEARING

BEFORE THE

SUBCOMMITTEE ON
CONSERVATION AND FORESTRY

OF THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE EFFECTS OF TAX REFORM ON THE TIMBER INDUSTRY

MARCH 13, 1989—MACON, GA

Printed for the use of the
Committee on Agriculture, Nutrition, and Forestry

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TAX ISSUES AFFECTING THE TIMBER INDUSTRY

MONDAY, MARCH 13, 1989

U.S. SENATE,
SUBCOMMITTEE ON CONSERVATION AND FORESTRY OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Macon, GA.

The subcommittee met, pursuant to notice, at 9:30 a.m., in the auditorium, Georgia Farm Bureau headquarters, 1640 Bass Road, Macon, GA, Hon. Wyche Fowler, Jr. (chairman of the subcommittee) presiding.

Present or submitting a statement: Senators Fowler and Pryor.

Also present: Representatives Lewis, Ray, Rowland, and Thomas, from the State of Georgia.

STATEMENT OF HON. WYCHE FOWLER, JR., A U.S. SENATOR FROM GEORGIA

Senator FOWLER. Let us take our seats. If I could invite you to take your seats, we will try to get started on time. I know a lot of you have driven from all over the State.

All the Baptists in the back row, we have plenty of seats down front here.

Ladies and gentlemen, good morning to you. My name is Wyche Fowler. I am pleased to serve you in the U.S. Senate.

This is the Subcommittee on Conservation and Forestry of the U.S. Senate. We have some of my colleagues from the House whom I will introduce. We are delighted to have them join us this morning.

This is one of the rare opportunities for us to come out of Washington on the ground to discuss matters of public policy, and I am delighted that not only we were able to work it out from the Washington end of it, but my special thanks to the Georgia Farm Bureau in hosting us in this official hearing in their wonderful new building. We will be hearing from their new president in a minute. I want to thank all the farmers of Georgia for allowing us to be in this wonderful facility.

I have a brief statement I want to make before we go to our hearing. Before that, let me introduce all of our participants from this end before we hear from you.

I am particularly delighted to welcome to Georgia my colleague, senior colleague in the U.S. Senate, Senator David Pryor of Arkansas. Senator Pryor is the chairman of the Subcommittee on Agricultural Production and Stabilization of Prices, and in that capac-

ity will be the lead Senator in the consideration of our new 1990 farm bill in all of its aspects as we go into hearings this year in preparation for the rewrite of the 1985 farm bill and the ultimate passage of our new farm bill either late this year or next year.

He is also the father of the taxpayers' bill of rights. He is the author of putting back the horse in front of the cart giving rights, warnings to taxpayers against undue harassment from the Internal Revenue Service. That was a 3-year battle which he saw to successful conclusion in its passage and signing by the President last year, and everybody, all of us hard working folks owe Senator David Pryor of Arkansas the great credit for that taxpayer protection that we enacted into the law of the land last year. Senator Pryor, we welcome you to Georgia.

He also is the senior member of the Finance Committee of the U.S. Senate. I could go on and on, but most importantly he is here to hear from tree farmers today, and there are about 100 other places that he could have been, including his own State, today. We welcome you, David, very, very much.

Senator PRYOR. Thank you, Wyche. [Applause.]

STATEMENT OF HON. DAVID H. PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. I am very pleased, ladies and gentlemen, to be with my good friend and colleague, Wyche Fowler. We serve on the Agriculture Committee together, we are in the so-called Democratic leadership together. He now is the assistant floor leader of the U.S. Senate on the Democratic side. He is rising very rapidly in the Senate. He is respected not only by the Democratic side, but also the Republican side as well. He is a bright and shining star as a Member, as a special new Member of the U.S. Senate.

Senator FOWLER. That was a paid political announcement. [Laughter.]

Senator PRYOR. And with our colleagues from the House, Wyche, thank you for inviting me and including me in such a very, very splendid group of people, because right here in this room we have a lot of mutual interests with people that I represent as tree farmers.

The timber industry in the State of Arkansas is a $4 to $6 billion a year industry, it is one of the largest revenues that we have in our State. We have seen for some time a basic erosion of the timber industry, and especially those small planters who operate tree farms and who really have been hit awfully hard by the 1986 tax bill.

In the election of 1984, running for a second term for the Presidency, Ronald Reagan, and you might remember the scene, held up a paper napkin about the size of this tablet, and he says "We are going to have a Tax Code that is going to be simple and fair, and is going to be one page long."

In 1985 the Ways and Means Committee and the Finance Committee on the Senate side started drafting the intention of what President Reagan had challenged to do. He said "I want to lower the rates, I want to bring equity and simplicity into our tax structure."

As a result of about 1½ years of labor, work, intensified disagreement, argument, dealing back and forth with the White House, the thousands of interests within the economic system of our country, finally in the spring and summer of 1986 the Ways and Means and Finance Committees produced the 1986 tax bill.

Senator Wyche Fowler, then on the Ways and Means Committee, opposed strongly those sections which took the capital gains and basically penalized segments of agriculture, and was very wisely in opposition.

On the Senate side we had people who opposed the change of the capital gains treatment for timber farmers. We lost those battles. And I must admit this, when the final 1986 tax bill came before the Senate I voted for it. I think perhaps, and I say this to my colleagues, had I known everything that was in the bill at that time and the impact, I might have voted a different way.

It is one of those legislative stories where we attempted to do the right thing, but as we went further and further into the Tax Code we made some changes that I think were wrong. Today I think we will hear about some of those changes that have had an adverse impact, and then perhaps we can talk about some ways we might find a solution to the problem that we are discussing this morning.

Thank you, Wyche, and thank you, ladies and gentlemen.

Senator FOWLER. Thank you, David, very much. [Applause.]

[The prepared statements of Senators Fowler and Pryor and Representative Lewis of Georgia follow:]

Hearing of the Forestry and Conservation Subsommittee
The Effects of Tax Reform on the Timber Industry
Opening Statement by Senator Wyche Fowler, Jr.
Macon, Georgia
March 13, 1989

I want to thank all my Georgia colleagues for their interest and participation in today's hearing. And I want to welcome to Georgia my friend Senator David Pryor of Arkansas.

Our panel witnesses today will be sharing with us their diverse perspectives, so that we can form as complete a picture as possible of the effects of the 1986 tax reform on the timber industry. In particular, we will be looking at the new rules for passive losses and capital gains that have been imposed.

The 1986 law eliminated the 60 percent exclusion for capital gains income, and the passive loss rules subject some forestry landowners to additional taxation. These changes have proven a strong disincentive to the small private landowners -- who account for 60 percent of our forest acreage -- at a time when we need to encourage the best possible management, in every dimension, of these valuable lands and timber resources.

We have to realize that in our attempt to root out the tax shelters of some millionaires we have also harmed tree farmers, the majority of whom net less than $20,000 a year. In ironing out some unfairness in tax policy -- which was the whole justification of tax reform -- we have inadvertently created other inequities. That is why I think we need to consider some readjustments. To do so, we must recognize the major differences between the timber industry and other investments to which capital gains and passive loss rules are applied.

Tree farmers are locked into a very long-term investment. Pine, spruce and cedar are not ciphers that flash across the board on the New York Stock Exchange, that can change hands with the stroke of a computer key. \ Tree farmers must patiently sweat out the risks from the markets and Mother Nature -- over decades. And a forest that grows on a thirty to sixty year cycle clearly is not managed like other investments. A car phone is not required.

It is essential, however, to promote stringent environmental protection in our forests. The necessary methods are costly. The former capital gains break helped defray the expenses of sound ecological practices -- such as leaving buffer strips of trees along waterways. It is also essential that we encourage replanting, that we discourage deforestation, for economic as well as environmental reasons.

For we cannot ignore in all this the importance of the timber industry to our economy. The value of timber production in the South is over $6.1 billion annually. Forest industries lead all other manufacturing in the number of employees and wages paid. That is added incentive to keep the industry healthy and place it on a sound course for the future.

Neither the economic nor the ecological facts of forestry are encouraging. Already more acres of trees are being harvested than are being planted. This situation is clearly not acceptable, and it has worsened since the tax reform of 1986.

President Bush's recent proposal to reduce capital gains tax rates across the board has generated a great deal of controversy over the projected effects on the economy and on tax revenues, and on the relative benefits to various classes of taxpayers.

I do not intend to explore those disputes of fact and philosophy here. Again, I want to emphasize that timber and forestry have special needs that may not correspond to those of the economy at large. That is where we want to focus our examination and our efforts in order to address those requirements that are important to the public interest.

We should, I suppose, entertain the question whether these goals of promoting a healthy industry and well-managed timber resources should be advanced through tax policy or other public incentives.

I think we can all agree that no one is proposing a return to the maze of special corporate interests protected in the old code, tax breaks for new strains of Christmas trees, or twice-subsidized National Forest giveaways. We are primarily concerned with smaller scale tree farmers on private lands whose livelihood has been threatened as we sought to shut down gratuitous tax shelters.

We are especially concerned about the decline in private landowners practicing forest management, and stewardship of our valuable forest resources, since the Tax Reform Act of 1986.

STATEMENT OF SENATOR DAVID PRYOR
FIELD HEARING ON TAX ISSUES AFFECTING THE TIMBER INDUSTRY
MACON, GEORGIA
MARCH, 13, 1989

I WANT TO THANK MY GOOD FRIEND FROM GEORGIA, SEN. FOWLER FOR EXTENDING TO ME THE OPPORTUNITY TO PARTICIPATE IN THIS FIELD HEARING. FURTHERMORE, I COMMEND SEN. FOWLER FOR SCHEDULING THIS, WHICH IS ONE OF THE FIRST FIELD HEARINGS THIS YEAR.

JUST AS YOU IN GEORGIA, WE IN ARKANSAS ARE BLESSED WITH A LARGE AMOUNT OF LAND THAT IS UNDER PINE TREES. THE MAJORITY OF OWNERSHIP IS IN THE HANDS OF SMALLER FARMERS, AND THEY ARE THE ONES WHO HAVE FELT THE STRONGEST IMPACT OF THE 1986 TAX REFORM ACT. IT IS THOSE WHO I HAVE IN MIND, AND FOR THAT REASON, I HOPE TO GAIN A CLEAR KNOWLEDGE AND UNDERSTANDING OF THE AFFECTS THE LAW HAS HAD ON YOU.

TIMBER REMAINS, AND HAS ALWAYS BEEN A MAJOR INCOME PRODUCER IN ARKANSAS, AND ACROSS THE SOUTH. HOWEVER, WE HAVE WITNESSED LESS AND LESS PLANTING OF THIS VALUABLE RESOURCE, AND THE FUTURE DOESN'T LEND ITSELF TO A BRIGHT INTERPRETATION OF WHAT TO EXPECT. IT IS MANDATORY THAT WE REPLENISH OUR STOCK OF TREES, FOR BOTH ECONOMIC AND ENVIROMENTAL REASONS.

SOME OF THE CHANGES IN THE 1986 ACT HAVE BEEN A DISINCENTIVE TOWARD THESE GOALS. WE MUST ATTEMPT TO DEFINE WHAT PATH SHOULD BE TAKEN TO REVERSE THE CURRENT TREND, AND CERTAINLY, WE MUST FIND AN ACCEPTABLE POLICY WHICH WILL PROVIDE AN ATMOSPHERE WHICH IS MORE FAVORABLE TO THE SMALL TREE FARMER.

AGAIN, MY THANKS TO SENATOR FOWLER FOR HOLDING THIS HEARING. AS CHAIRMAN OF THE SENATE AGRICULTURE COMMITTEE'S SUBCOMMITTEE ON CONSERVATION AND FORESTRY, HE WILL BE A LEADER IN THIS FIELD. I LOOK FOWARD TO WORKING WITH HIM.

PREPARED STATEMENT OF HON. JOHN LEWIS, A REPRESENTATIVE IN CONGRESS FROM THE FIFTH CONGRESSIONAL DISTRICT, STATE OF GEORGIA

13 MARCH 1989
MACON, GEORGIA
FARM BUREAU BLDG.

UNITED STATES SENATE
SENATE AGRICULTURE COMMITTEE
SUBCOMMITEE ON CONSERVATION AND FORESTRY
SUBCOMMITTEE CHAIRMAN: SENATOR WYCHE FOWLER, JR.

FIELD HEARING; TO DISCUSS TAX ISSUES AFFECTING THE TIMBER INDUSTRY; CAPITAL GAINS EXCLUSION AND PASSIVE\LOSS

PANELISTS:
U.S. SENATOR WYCHE FOWLER, JR.-SUBCOMMITTEE CHAIRMAN
U.S. SENATOR DAVID PRYOR, ARKANSAS
U.S. REP. RICHARD RAY
U.S. REP. J. ROY ROWLAND
U.S. REP. LINDSAY THOMAS
U.S. REP. JOHN LEWIS

STATEMENT:

I WANT TO THANK SEN. FOWLER FOR THE OPPORTUNITY TO HEAR THE TESTIMONY OF THE WITNESSESS GATHERED TODAY CONCERNING THE TAX ISSUES FACING GEORGIA TREE FARMERS AND THE TIMBER INDUSTRY.

I AM ANTICIPATING LEARNING A GREAT DEAL ABOUT THE DIFFICULTIES ENCOUNTERED BY TREE FARMERS AS A RESULT OF THE CHANGES BROUGHT ABOUT BY THE TAX REFORM ACT OF 1986, THE MAJOR CHANGES BEING THE LOSS OF THE CAPITAL GAINS EXCLUSION AND THE PASSIVE\LOSS REQUIREMENTS.

THE TAX REFORM ACT OF 1986, THE MOST COMPREHENSIVE OVERHAUL OF OUR FEDERAL INCOME TAX SYSTEM IN MORE THAN 30 YEARS, HAS SUBSTANTIALLY LOWERED TAX RATES WHILE ELIMINATING OR REDUCING MANY DEDUCTIONS, EXCLUSIONS, AND CREDITS INTRODUCED OVER THE YEARS. THIS TAX LAW, LIKE THOSE BEFORE IT, AFFECTS TIMBERLAND VALUES, OWNERSHIP AND LAND USE, AND STEWARDSHIP.

BECAUSE OF THE LONG TERM NATURE OF FORESTS, IT IS NECESSARY TO LOOK AHEAD---20--30---OR EVEN 50 YEARS, AND BECAUSE ABOUT TWO-FIFTHS OF ALL U.S. TIMBERLAND IS IN THE SOUTH, IT IS MY GOAL TODAY TO SEEK OUT WAYS TO ENSURE SOUND TIMBERLAND MANAGEMENT AND STEWARDSHIP PRACTICES FOR THE TREE FARMER IN THE SOUTH.

LASTLY, I WANT TO THANK THE WITNESSES APPEARING BEFORE US TODAY FOR THE PREPARATION OF THEIR TESTIMONY, WHICH WILL ALLOW US TO MORE FULLY CONSIDER THE PROBLEMS FACING THE TREE FARMER AND THE TIMBER INDUSTRY.

Another piece of legislation on the House side is H.R. 1086 which aims to correct IRS regulations—stemming from the 1986 Tax Act—which prevent small landowners from deducting timber growing expenses prior to harvest.

Mr. Chairman, thank you again for providing those of us who are concerned about the tax treatment of the timber industry an opportunity to express our views. I certainly look forward to the testimony of our distinguished witnesses we will have here this morning.

Senator FOWLER. Thank you, Roy, very, very much. [Applause.]

[The prepared statement and letter of Representative Rowland follow:]

STATEMENT BY: REP. J. ROY ROWLAND

HEARING: SENATE AGRICULTURE SUBCOMMITTEE ON CONSERVATION AND FORESTRY

SUBJECT: TAX ISSUES AFFECTING THE TIMBER INDUSTRY

DATE: MARCH 13, 1989

Mr. Chairman, I want to thank you for arranging this hearing today and for focusing in on such a vital issue of concern to the timber industry. The tax treatment of timber income has tremendous consequences for our State. Forestry is Georgia's number one industry, contributing more than 9 billion dollars per year to the economy and employing more than 80,000 people.

For more than 40 years, sound tax incentives, which took into account the unique nature of the timber industry and the risks of long-term investment, fostered the growth of the timber industry in Georgia and across the Nation.

However, in the last few years it seems as though the timber industry has become "persona non grata" as far as the Federal Government is concerned. The Tax Reform Act of 1986, which I opposed, took away important tax incentives that had been created to help encourage the production of timber. We now find ourselves fighting to restore these incentives in order to maintain the economic security of the industry.

Mr. Chairman, I was disappointed that President Bush excluded timber from his proposal to restore a preferential capital gains tax rate. I have written him a letter asking him to correct this oversight. I am, however, pleased that initiatives have been introduced in the 101st Congress which seek to correct some of the problems I have mentioned.

For instance, I have cosponsored H.R. 1029, a bill which would restore the preferential treatment for capital gains income obtained from timber.

Additionally, I am cosponsoring H.R. 1086, which aims to correct IRS regulations - stemming from the 1986 Tax Act - which prevent small landowners from deducting timber growing expenses prior to harvest.

Mr. Chairman, thank you again for providing those of us concerned about the tax treatment of the timber industry an opportunity to express our views. I look forward to the testimony of our distinguished witnesses.

(Letter to the President follows:)

J. ROY ROWLAND
8TH DISTRICT, GEORGIA

COMMITTEES
ENERGY AND COMMERCE
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February 24, 1989

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

Timber growers in my state and around the country have suffered considerably from the unfair treatment they received under the 1986 Tax Reform Act. The Act eliminated their capital gains tax rate. And an Internal Revenue Service interpretation of the Act prohibited the deduction of yearly operating expenses prior to harvesting by non-industrial growers. Because it takes so long for timber to generate income, the special capital gains rate and the deduction of operating expenses are both fair and necessary for the economic health of this industry.

Mr. President, the fact that timber growers are not included in your capital gains tax rate proposal is viewed by timber producers as further injury to their industry.

The purpose of this letter is to request your consideration for extending eligibility for capital gains treatment to timber growers in your proposed legislation. You maintain that a lower capital gains tax rate can stimulate the economy enough to increase revenue. If this is true, I believe the capital gains tax can particularly serve as a stimulus for the timber industry.

Thank you for your consideration of this request.

Sincerely,

J. ROY ROWLAND

Senator FOWLER. Another senior member and distinguished public servant, a friend of all Georgians from Perry, Congressman Richard Ray. Thank you for being here, Richard.

STATEMENT OF HON. RICHARD RAY, A REPRESENTATIVE IN CONGRESS FROM THE THIRD CONGRESSIONAL DISTRICT, STATE OF GEORGIA

Mr. RAY. Thank you, Wyche.

Mr. Chairman and Senator Pryor, we appreciate very much you taking the time and making the effort to come to Macon today to hold this hearing. I am especially pleased that it is being held here in the Georgia Farm Bureau building. I am happy to be in Congressman Rowland's district, and I am happy to have my colleague, Congressman Lindsay Thomas here to testify and to be a member of this panel this morning.

As a member of what I like to call Congressman Lindsay Thomas' Forestry 2000 Task Force I am very interested in the treatment of the Nation's timber growers. We must encourage investment in the timber growing business and industry, and it is necessary to ensure the Nation's future supply of timber.

Georgia's timber industry is a very strong contributor to the State's economy and the Nation's economy, as has been pointed out. I am certainly committed to doing what is necessary as a Member of the Congress to help it remain a viable and strong industry.

I am supportive of restoring the capital gains treatment for timber generated income. I will do everything that I can to see that H.R. 1029, introduced by Congressmen Sid Morrison and Les AuCoin, receives favorable treatment in the House of Representatives. This bill would establish a three tiered capital investment rate differential for individuals at all income levels.

President Bush's fiscal year 1990 budget contains a major initiative, as Congressman Rowland has pointed out, to restore a favorable capital gains rate to the Tax Code. However, the proposal would restore capital gains benefits for individuals only on investment assets, but it does not include timber.

H.R. 1029 would exclude from personal income tax 40 percent of the gain on investments in timber held for 1 year, 60 percent of the gain on investments held for 3 years, and 100 percent of the gain on investments held for 5 years.

Mr. Chairman and Senator Pryor, I pledge my full support to this legislation and other necessary legislation to restore the capital gains treatment for timber and provide the tax incentive which will encourage continued investment in the timber growing industry.

I am happy to be with you here today. Thank you.

Senator FOWLER. Thank you, Representative Ray. [Applause.]

[The prepared statement and point paper on capital gains tax of Mr. Ray follow:]

STATEMENT OF CONGRESSMAN RICHARD RAY
HEARING ON TAX ISSUES AFFECTING THE TIMBER INDUSTRY
GEORGIA FARM BUREAU HEADQUARTERS
MACON, GEORGIA
MARCH 13, 1989

I WOULD LIKE TO EXPRESS MY APPRECIATION TO SENATOR FOWLER FOR SCHEDULING THIS HEARING TO DISCUSS TAX ISSUES AFFECTING THE TIMBER INDUSTRY. IT IS A PLEASURE TO BE HERE IN MACON AT THE GEORGIA FARM BUREAU HEADQUARTERS WITH SENATOR DAVID PRYOR OF ARKANSAS, CHAIRMAN OF THE SUBCOMMITTEE ON AGRICULTURAL PRODUCTION AND STABILIZATION OF PRICES, AND MY FELLOW GEORGIA DELEGATION COLLEAGUES, CONGRESSMEN ROY ROWLAND, LINDSAY THOMAS, AND JOHN LEWIS.

AS A MEMBER OF THE FORESTRY 2000 TASKFORCE, I AM VERY INTERESTED IN THE TREATMENT OF THE NATION'S TIMBER GROWERS. WE MUST ENCOURAGE INVESTMENT IN THE TIMBER GROWING BUSINESS TO ENSURE THE NATION'S FUTURE SUPPLY OF TIMBER.

GEORGIA'S TIMBER INDUSTRY IS A VERY STRONG CONTRIBUTOR TO THE STATE'S ECONOMY. I AM COMMITTED TO DOING WHAT IS NECESSARY TO HELP IT REMAIN A VIABLE AND STRONG INDUSTRY.

I AM SUPPORTIVE OF RESTORING THE CAPITAL GAINS TREATMENT FOR TIMBER GENERATED INCOME. BECAUSE OF MY INTEREST IN GEORGIA'S TIMBER GROWERS, I WILL BE SIGNING ON AS A COSPONSOR TO THE CAPITAL INVESTMENT ACT, WHICH WAS RECENTLY INTRODUCED AS H.R. 1029 BY CONGRESSMEN SID MORRISON AND LES AUCOIN. H.R. 1029 IS LEGISLATION TO RESTORE THE CAPITAL GAINS TREATMENT OF TIMBER GENERATED INCOME. THIS BILL WOULD ESTABLISH A THREE-TIERED CAPITAL INVESTMENT RATE DIFFERENTIAL FOR INDIVIDUALS AT ALL INCOME LEVELS.

PRESIDENT BUSH'S FISCAL YEAR 1990 BUDGET CONTAINS A MAJOR INITIATIVE TO RESTORE A FAVORABLE CAPITAL GAINS RATE TO THE TAX CODE. HOWEVER, THE PROPOSAL WOULD RESTORE CAPITAL GAINS BENEFITS FOR INDIVIDUALS ONLY ON "INVESTMENT ASSETS." OTHER ASSETS, SUCH AS TIMBER, WOULD BE DENIED CAPITAL GAINS TREATMENT.

H.R. 1029, WOULD EXCLUDE FROM PERSONAL INCOME TAX 40 PERCENT OF THE GAIN ON INVESTMENTS HELD FOR ONE YEAR, 60 PERCENT OF THE GAIN ON INVESTMENTS HELD FOR THREE YEARS, AND 100 PERCENT OF THE GAIN ON INVESTMENTS HELD FOR FIVE YEARS.

MR. CHAIRMAN, I PLEDGE MY FULL SUPPORT TO THIS LEGISLATION AND OTHER NECESSARY LEGISLATION TO RESTORE THE CAPITAL GAINS TREATMENT FOR TIMBER AND PROVIDE THE TAX INCENTIVE TO ENCOURAGE CONTINUED INVESTMENT IN THE TIMBER GROWING INDUSTRY.

THANK YOU.

(Point Paper on Capital Gains Tax follows:)

POINT PAPER ON CAPITAL GAINS TAX

CONGRESSMAN RICHARD RAY

MARCH 1989

President Bush has proposed a reduction in the tax rate on capital gains. Currently, capital gains are taxed as ordinary income. This change was made in the 1986 Tax Reform Act.

The President's proposal would reduce the tax on capital gains to 15 percent. The new rate would be tied to new, longer holding periods for assets. By 1995, a taxpayer could get the low rate only on gains from the sale of assets held three years or longer. The plan would limit the preferential rates to corporate securities, land and owner-occupied housing. Before capital gains began being treated as ordinary income, assets eligible for special treatment also included property qualifying for depreciation write-offs, such as mineral reserves and commercial real estate, as well as paintings and other "collectibles." The new rates would cover about three-fourths of the assets that previously qualified, measured by dollar value.

There is a great amount of disagreement over the revenue impact of the President's capital gains proposal. The Treasury has estimated that the tax reduction will stimulate $4.8 billion in FY 1990 and $16.1 billion in 1989-93. From 1994-96, the plan would lose $20.1 billion. However, after that time, the Treasury should gain $2 billion a year.

One reason for these revenue estimates is due to the way in which the holding period is phased in. Under the Bush proposal, a taxpayer would get the lower rate for gains on property that he had owned for at least a year, as of June 1989. In 1993 and 1994, a two-year holding period would apply, and in 1995 the three-year holding requirement would become effective. The phasing in of longer holding requirements would produce positive tax receipts until 1993. Treasury officials believe that as investors see two-year and three-year requirements approaching, they will sell to avoid being locked in for longer periods.

The Congressional Joint Taxation Committee staff has estimated that the Bush proposal would lose $24.2 billion in 1989-94. However, it would produce $3.3 billion in FY 1990.

Congressman Dan Rostenkowski, Chairman of the Ways and Means Committee, has expressed strong reservations about the Bush capital gains proposal. He believes it will lose revenue in the long run, and he is also concerned about re-opening the tax code so soon after the enactment of the 1986 Tax Reform bill. Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, has expressed an interest in examining the Bush proposal, but has not indicated that he either supports or opposes the plan.

Senator FOWLER. Last but not least, who is going to lead off from the witness table, is our friend and fine First Congressional District Congressman from the coast, a member of the Appropriations Committee and Chairman of the Forestry Task Force in the House of Representatives to present some remarks is Congressman Lindsay Thomas. He is going to combine as a panelist and a witness to tell us about his bill.

Congressman Thomas, we welcome you as our lead-off witness.

STATEMENT OF HON. ROBERT LINDSAY THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE FIRST CONGRESSIONAL DISTRICT, STATE OF GEORGIA

Mr. THOMAS. Thank you, Mr. Chairman, Senator Pryor, my colleagues from the House, it is great to be here with you.

I appreciate the opportunity to provide testimony to the Senate Agriculture's Subcommittee on Conservation and Forestry regarding tax issues affecting the timber industry. I also appreciate the opportunity to appear before my friend, Senator Pryor, in his capacity as chairman of the Subcommittee on Agricultural Production and Stabilization of Prices—and of course, before fellow Members of the Georgia delegation.

For a while I thought it was going to become a little bit like an old fashioned revival where some of us did penance for having voted for the 1986 bill, and others took credit for having opposed it, but I would point out that perhaps the reason we are here today is to address some of the very things that occurred as a result of the 1986 tax bill, and as one of the reasons, of course, the deep hit that was taken by our land-based industries of timber and agriculture that I could not support the bill from the beginning.

Mr. Chairman, I might say that I do have formal testimony that I will submit for the record, and a letter from E.T. Mullis, from Statesboro, GA, that I would like to put in along with my prepared statement. I will try to make my comments to the panel here as brief as possible because I know there are many others who have testimony as well.

I speak to you today, Mr. Chairman, not only as an individual Member of Congress, but also as an individual certified tree farmer and landowner. I know firsthand from my own experience in growing trees the truly difficult circumstances now facing landowners, like those gathered right here in this room, and everywhere across the country as a result of the Tax Reform Act of 1986. I still grow trees and practice the best management possible to enhance the productivity of my land. However, Mr. Chairman, I can report to you and the members of this panel that certain aspects of the Tax Code are now literally draining the vitality of an entire industry in a way that was not fully contemplated when the tax bill was passed, and I hope in a way that certainly was not intended.

I also speak to you today also as the cochairman of an organization in the U.S. House of Representatives called the "Forestry 2000 Task Force." The "Forestry 2000 Task Force" is made up of 113 Members of Congress, over one-fourth of the entire House, whose Members have a strong interest in matters which affect forestry and the sound, long-term management of America's vital renew-

able timber resource. All my fellow Georgia House Members here today are members of the Forestry 2000 Task Force. I can assure you, Mr. Chairman, that they, as I, are concerned that the Tax Reform Act of 1986 is severely damaging the economic health of landowners and our foresters all across America.

The Tax Reform Act of 1986 contains two provisions which are now proving to be major obstacles in encouraging sound forestry management practices. That is, of course, the loss of capital gains rate differential, and the unfair application of the passive activity loss rules to timber growing activities. Understanding the time constraints of the hearing, I will only briefly discuss each issue.

The history of private forestry in the United States is directly related to the capital gains treatment of timber. Prior to 1944, when the capital gains treatment of timber was first enacted, we were headed for a dramatic shortfall in timber production in this country versus what we were cutting. The United States had less timber at the end of every year than at the start. After the passage of that or inclusion of timber in 1944 we began to slow down very dramatically that margin of timber shortfall, we were doing a much better job of reforesting our land. That trend has been reversed and timber plantings and U.S. growing stock have increased dramatically.

As we know, growing trees is a long term, risky enterprise. For individual timber owners who have cared for their trees for 25 to 75 years, the loss of the lower capital gains tax rate is unfair. Original investment decisions for many timber owners were based on capital gains tax treatment of this long-term income, which in many cases is only once or twice in a landowner's lifetime income. Moreover, without the capital gains differential, which has been a part of the Tax Code now for over 40 years, future investments in growing trees will be highly unattractive, and that is attested specifically by the dramatic number of seedlings in the State of Georgia that will not even be replanted, will not be utilized to reforest the lands this year, and our forester Mr. Mixon will be here, and I am sure will give those figures, but it is over 14 million trees that we will not be replanting.

Our forests are the most productive forestlands in the world because of the huge timber growing investments that are made to increase productivity. Without the capital gains rate differential, investments in growing long-term timber crops are economically unfeasible.

The economic impact of not having a capital gains differential is widespread. Not only will it affect the country's long-term supply of timber, but it will be reducing job opportunities in rural America, with our Georgia landowners particularly hard hit.

A good example is our colleague, Mr. Lewis, who will join us later, even though he is from the city of Atlanta, the great bulk of those 80-something-thousand jobs generated in the State of Georgia reside right there in the urban area of Atlanta as a result of this industry.

In my view it will further aggravate industrial location, jeopardize our resource base, and disadvantage U.S. competitiveness in international markets. A major international issue to us in an area where we are still highly competitive, the forestry industry.

However, Mr. Chairman, there is another impact which also concerns me greatly. That is the impact on encouraging sound forest management practices, especially as they relate to enhancing the overall environmental quality of our forests and surrounding communities. Our professionally managed forests provide vital wildlife enhancement, water quality, a hedge against soil erosion, they create aesthetic beauty for us and recreational needs. And as you may know, reforestation can play, we are learning, a key role in efforts to combat the so-called greenhouse effect, while at the same time, the land is growing trees for the future supply of wood for jobs and America's homes.

My colleague, Senator Wirth, made the comment Friday in Pennsylvania that it probably would be best if every young American born in this country came here with a certified birth certificate and 300 seedlings to plant. So we are beginning to realize that the planting of trees is an aid in this issue.

The second issue, Mr. Chairman, which is causing a growing outrage among individual timber growers is the application of the passive activity loss rules as they apply to timber growing activities.

When the Tax Reform Act of 1986 was enacted, the passive loss rules became law in an attempt to curb abusive tax shelters. However, timber growing is not a tax shelter, and that is something our committees need to keep in sight. Timber growing activities do not bear any of the characteristics of tax shelters with which Congress was concerned when we enacted the passive loss rules in the beginning. Now, under the proposed regulations, timber owners may be precluded from currently deducting legitimate management expenses and carrying costs arising from their timber growing activities. These generic regulations do not take into account the unique nature of timber and the long growing cycles that are involved.

In my opinion, and in that of many other Members of Congress, the result is detrimental, specifically, to sound forestry policy. In that regard, Mr. Chairman, I recently cosponsored, together with the other cochairman of the Forestry 2000 Task Force, H.R. 1086, which is the Farmers and Woodland Owners Tax Simplification Act of 1989, which would clarify the application of passive losses to timber growing. With respect, Mr. Chairman, I would urge you and your colleagues to review our bill and endorse a similar approach in the Senate. As I said in our press conference when the bill was introduced, "at a time when our President and leaders throughout the world are talking about issues such as global warming, acid rain, and the greenhouse effect, our U.S. Tax Code is forcing many landowners to cut their trees and not replant. We need to create incentives for reforestation, not incentives to abandon this renewable resource of our forests. We are telling farmers in South America to stop cutting the tropical rain forests, and at the same time our U.S. Tax Code is forcing our farmers to stop reforestation."

That statement is one that I truly believe, Mr. Chairman. We need to provide our landowners and our tree farmers with a fair, equitable economic environment which, in turn, will provide all America with a sound, stable renewable resource base which continously contributes to our overall quality of life.

So, in that regard, Mr. Chairman, I want to thank you for the opportunity to present these comments today. On behalf of the For-

estry 2000 Task Force, we hope that you will take them into account as you consider these important issues in the Senate.

Thank you, Mr. Chairman, members of the panel. If there are any questions I will certainly be glad to attempt to answer those at this time. [Applause.]

Senator FOWLER. Thank you, Representative Thomas.

[The letter of E.T. Mullis, Statesboro, GA, follows:]

501 Pitt-Moore Rd.
Statesboro, Georgia 30458
February 21, 1989

FEB 27 1988

Representative Lindsay Thomas
431 Cannon House Office Building
Washington, D. C. 20515

Dear Representative Thomas,

I am a small tree farmer in Bulloch County and retired from the USDA Soil Conservation Service. I own 173 acres of woodland which I bought in 1962 for $100 per acre. This land was cut-over land (everything sold off that could be harvested) so I had to plant pines and kill competing scrub hardwood. I received some financial assistance from USDA Agricultural Conservation Program (ACP) which reduced my out-of-pocket expenses to about $75 per acre.

So I have a capital investment of $175 per acre in my timber (not including my labor and equipment use and family labor). Interest at 7% of $175 would be $12 per acre. State and County property taxes is $2 per acre, making a total expense of $14 per acre per year. Let's say my timber is growing 1 cord of wood per acre per year (which is very good indeed) and I can sell it for $30 per cord. My income would be $30 minus $14 or $16 per acre per year for my labor and equipment. The return on my capital ($175) and labor and equipment (which is not factored in) would be 9% ($16 ÷ $175). This is a small return when you consider the work and worry I have expended plus the hazards of fire, wind, ice, insects, etc.

Now when I sell my timber (which I need to sell some now) it will be taxed at 28% (because of lump-sum payment). Take 28% of my profit of $16 ($4.50) which leaves $11.50. Divide this by $175 and my net return to capital, labor and equipment is only 6½%.

Under the present tax law, which disallows any capital gains, timber growing will not pay. If I had to pay for my time and equipment use, I would lose money. It is simply unfair to tax timber income at regular tax rates because I have been paying taxes on it over the years without any income!

And to say that capital gains exclusions from taxes would only benefit the rich is a fallacy when applied to timber growing. I am certainly not rich, but when I sell timber I will be taxed at the rich tax rate! This is not fair.

I would appreciate it very much if you would give careful consideration to changing the tax law to allow for capital gains exclusions for timber.

Thanking you in advance, I am

Sincerely yours,

E. T. Mullis

E. T. Mullis

Senator FOWLER. On behalf of the panel I not only want to thank you for your testimony and your leadership on this issue, but you have saved me making my statement. I will submit it to the record because you have done a very fine job of summarizing the problem, as well as the opportunities if we have sense enough to make some changes where we were just plain wrong in our government's policy.

Let me say in reaction then to, also to all concerned, I appreciated Senator Pryor's kind words about my fight a couple of years ago in predicting what would be very bad consequences for all of our timber industry if we removed the capital gains from timber and made some of the changes that were made.

We cannot go back to that now, there is no point in it, but the reason I was so anxious for this hearing to be had at this time, and insisted that it be in Georgia, is that if President Bush is serious about reopening the whole issue of capital gains treatment in the Tax Code, I do not want it narrowed down to the trading of assets for millionaires, I want that to be the opportunity for us to make the record here today and see how our national interest has been harmed by changes in the Tax Code affecting our timber industry throughout our country.

So you have set the tone extremely well, we will be looking certainly at your legislation and others' who are attempting to deal with this problem, and I thank you very much for your presentation and your leadership.

Mr. THOMAS. Thank you, Mr. Chairman. [Applause.]

Senator FOWLER. We welcome the new president of the Georgia Farm Bureau, Mr. Mort Ewing. We are delighted to have you as our lead-off lay witness, President Ewing. After all of us politicians have had our say, now we are going to get the truth out from the rest of the witnesses.

Let me do say that both Senator Bill English, the Chairman of the Georgia Senate Agriculture Committee in the General Assembly, and representative Henry Reaves, the Chairman of the Georgia House Agricultural Committee, both were scheduled to be with us this morning and testify, but because of the session in Atlanta could not be with us this morning, but I certainly want to note that they not only were invited, they were eager to testify but simply were unable to do so because of the legislative session.

President Ewing, we welcome you and are delighted to hear from you in any manner you wish.

STATEMENT OF T.M. "MORT" EWING, PRESIDENT, GEORGIA FARM BUREAU FEDERATION, MACON, GA

Mr. EWING. Thank you, sir.

Senator Fowler, Senator Pryor, and distinguished members of the Georgia delegation, on behalf of all Georgia farmers, I want to thank you for holding this hearing today on an issue of great importance to the future. I have looked forward to this opportunity to comment on the effects of the Tax Reform Act of 1986 on the forestry industry. I further want to welcome you to Macon and to the State headquarters of the Georgia Farm Bureau Federation. We are proud of our organization and we hope you will take time to

look around at the many services we offer our membership. I represent the collective wisdom of the over 176,000 members of the Georgia Farm Bureau Federation. Our organization has an extensive policy development procedure which includes the entire membership starting at the county level on through the national level. We feel our policy positions are very reflective of Georgia farmers. One of the most discussed issues the past 2 years has been the loss of capital gains on timber and the need to have this tax treatment restored.

Forestry is big business in Georgia. The forest-related industries rank No. 1 in the value of products and the number of employees. The industry is valued at $8.74 billion and employs around 80,000 Georgians. Georgia continues to be the Nation's leading producer of pulp and paper as well as being a major world producer. The State's climate and soil are near perfect for wood production, especially for southern pines which grow to pulpwood size in 15 years and sawtimber in about 25 years. Georgia has more commercial forests than any other State. Changes in the economics of the industry affect our State and affect Georgia farmers. Over the years, the utilization of Georgia wood products have grown tremendously. This demand for wood products has caused tree farmers to try to supply the needs. Even though the harvest of trees has been greater than reforesting efforts, the gap has been closing due to the positive economics of the industry. This closing of the gap has been slowed in Georgia due simply to the tax ramification of the Tax Reform Act of 1986 and to the pressures of local property taxes. We know that you cannot address the local tax issue, Mr. Chairman, but I did want to let you know that the increased financial needs of local governments are causing a tremendous tax burden on landowners. As for the effects of the Tax Reform Act of 1986, you can address the hindrances that have been created, or should I say the incentives that were removed. Even though there is a relatively high demand for timber products, the risks involved and the tax obligations destroy most of the incentives to produce the commodity.

Restoration of the capital gains tax treatment for timber will create jobs, increase investment, and enhance the conservation of the environment. Mr. Chairman, it must be accomplished.

Timber is an important crop for farmers. It represents a long-term investment for the future; it helps pull many farmers through lean times on the farm; and it is one of the best conservation practices for preventing soil erosion and for the protection of water quality. In many cases, timber acreage is the retirement system for Georgia agriculture. Forests also provide wildlife preservation and many opportunities for recreation.

The changes made in the Tax Reform Act of 1986 made timber production a lackluster investment, or very low return investment for the farmer. The expected after-tax return, coupled with the risk of growing timber, make forestry investments a very poor management decision. Timber is an important agricultural product, and it is in jeopardy because of the changes in the tax law.

A dangerous precedence toward harvesting more timber than is planted is rippling across the South, and this trend needs to stop. It restricts future growth and is damaging to the environment.

The 1986 act broke a nearly 40-year commitment to forest landowners when tax rates were lowered for long-term investments. The dropping of the capital gains from the U.S. Tax Code was an unfortunate consequence of a legislative compromise to lower the marginal tax rate and supposedly simplify the Tax Code.

The lost capital gains treatment also affected another growing agricultural enterprise—environmental horticulture. Some horticultural products, that have several years of production, lost the preferential tax treatment also. The expanding Christmas tree industry is an example of such a product. Ornamental shrubs represent another growth crop that would benefit from capital gains restoration.

There is much debate on whether or not the capital gains tax rate should be lowered. From the political standpoint the question arises: Can lower capital gains tax actually increase government receipts through greater investment and other economic activity? From the economic standpoint, the issue should be studied on the justification and equality merits. There is no justification for a capital gains tax, period. Capital gains largely reflects the change in prices of capital assets caused by inflation. A better description is that a capital gains tax is, in fact, an inflation tax. A tax on capital gains is ultimately a tax on jobs and opportunities. In the case of timber a tax on the environment.

Many other countries in the world recognize the gross inequity of a capital gains tax. Two of the United States' biggest competitors in the world trade arena, Japan and West Germany, do not have capital gains. This is one reason why capital formation in those countries has accelerated at a faster pace than the United States in recent years. Other industrialized countries have cut back the capital gains tax in recent years, or have a much slower tax rate.

The perceived notion offered by those who oppose the capital gains tax, or any cut in taxes, is that it results in less tax revenue. Past experience with taxes in general, and capital gains tax in specific, strongly refutes this argument. In 1978 when the Steiger amendment was proposing that the capital gains tax be reduced from 49 percent to 28 percent, the Department of Treasury estimated related tax revenues would decline $2 billion annually. When the tax rate was reduced, capital gains tax revenues rose by $1.8 billion per year.

Government, through policy decisions, attempts to control the well-being of the country. Tax considerations are made to increase investments in research, encourage the purchase of homes, to save for retirement and other items. A capital gains exclusion or a lower capital gains tax would tell America to invest in the future. It will signal to farmers that trees are an important resource and their production is vital for the future.

Several measures have been introduced in the U.S. Senate and House of Representatives to lower the tax burden on capital gains. President Bush has also initiated legislation to relieve the inequities of the Tax Reform Act of 1986 on capital gains. We support these efforts, and urge you to use your influence to gather bipartisan support to have a capital gains tax treatment enacted into law. Since some of the pending proposals do not include timber, we hope

you will promote the tremendous need for the tax differential in the forestry industry.

Everyone will be winners. Farmers will continue to create a valuable renewable resource. The Nation as a whole will benefit in the form of increased economic activities, more jobs, higher total Federal tax revenues, and an enhanced environment.

Mr. Chairman, Senator Pryor, the congressional delegation, thank you for this opportunity to express the position of the Georgia Farm Bureau. [Applause.]

Senator FOWLER. Thank you, Mr. Ewing.

Mr. EWING. Mr. Chairman——

Senator FOWLER. Yes.

Mr. EWING. I mentioned earlier about Senator English and Mr. Reaves not being here today and the fact that the general assembly was in session. They have asked me to submit written comments for the record.

Mr. Reaves' comments are in the form of House Resolution No. 349, which is a resolution passed by the Georgia House urging Congress to enact a long-term capital gains differential for timber and, Mr. Chairman, I submit those for your consideration.

Senator FOWLER. Without objection, they will be included. We will be glad to include those.

Mr. EWING. Thank you very much.

[The prepared comments of Georgia Senator Bill English and Georgia Representative Henry Reaves follow:]

BILL ENGLISH
District 21
214 Golf Drive
Swainsboro, Georgia 30401

The State Senate
Atlanta, Georgia 30334

COMMITTEES:
Agriculture, Chairman
Appropriations
Human Resources
Interstate Cooperation
Natural Resources

SUBCOMMITTEES:
Aging
Parks and Historic Sites

MEMORANDUM

TESTIMONY: To: The Senate Agriculture Committee's Subcommittee on Conservation & Forestry

Monday, March 13, 1989 9:30 A.M.

Macon, Georgia

Georgia Farm Bureau Headquarters

FROM: Senator Bill English, Chairman
Senate Agriculture Committee

TAX ISSUES AFFECTING THE TIMBER INDUSTRY

GOOD MORNING---

IT IS A PLEASURE TO BE HERE TODAY TO DISCUSS ISSUES AFFECTING THE TIMBER INDUSTRY. I WOULD LIKE TO THANK SENATOR FOWLER FOR TAKING SUCH AN ACTIVE ROLE IN THIS AREA WHICH IS OF SUCH VITAL CONCERN TO THE STATE OF GEORGIA.

AS MOST OF YOU ARE WELL AWARE, FORESTRY IS OF VITAL IMPORTANCE TO THE ECONOMY OF THIS STATE, ESPECIALLY TO ITS RURAL AREAS WHICH HAVE NOT ALWAYS SHARED IN THE ECONOMIC GROWTH OF THE PAST DECADE. THE FOREST INDUSTRY CONTRIBUTES OVER $8.7 BILLION TO OUR ECONOMY EACH YEAR AND EMPLOYS OVER 80,000 PERSONS. THE FUTURE ECONOMIC VITALITY OF THIS INDUSTRY DEPENDS ON A HEALTHY BUSINESS CLIMATE THAT ENCOURAGES THE DEVELOPMENT AND PROPER MANAGEMENT OF OUR STATE'S FORESTS.

IN RECENT YEARS, HOWEVER, DEVELOPMENTS HAVE OCCURRED WHICH HAVE CALLED INTO QUESTION THE ABILITY OF THIS INDUSTRY TO CONTINUE TO PROSPER IN THE FUTURE. DURING THE LAST FIVE YEARS IN GEORGIA, AN AVERAGE OF 640,000 ACRES OF FOREST HAVE BEEN HARVESTED ANNUALLY WHILE AN AVERAGE OF ONLY 473,000 HAVE BEEN REFORESTED. THIS SUBSTANTIAL EXCESS OF HARVESTED ACRES OVER REFORESTED ACRES WILL LEAD TO AN INADEQUATE TIMBER SUPPLY IN

THE FUTURE. RECENT CHANGES IN BOTH STATE AND FEDERAL TAX LAWS WILL ONLY HELP TO EXACERBATE THIS PROBLEM.

THE TAX REFORM ACT OF 1986 MADE SUBSTANTIAL CHANGES IN TAXES AFFECTING THE TIMBER INDUSTRY. THE PREFERENTIAL CAPITAL GAINS TAX ON TIMBER WAS ELIMINATED, RESULTING IN AN INCREASE IN THE TAX RATE ON TIMBER INCOME FROM 20 PERCENT TO AS MUCH AS 33 PERCENT. SINCE GEORGIA'S INCOME TAX IS IN CONFORMITY WITH THE FEDERAL TAX, THE TAX AT THE STATE LEVEL ROSE FROM 2.7 PERCENT TO 6 PERCENT. THE COMBINED STATE AND FEDERAL TAXES WENT FROM 22.7 PERCENT TO 39 PERCENT.

THESE INCREASES IN TAXES ALONE WOULD TEND TO STIFLE INVESTMENT IN TIMBERLAND BY MAKING IT DIFFICULT FOR INDIVIDUALS TO RECOUP THEIR INVESTMENTS OVER THE LONG TERM. UNFORTUNATELY, THE 1986 TAX LAW CHANGES MADE ADDITIONAL CHANGES HARMFUL TO THE INVESTMENT CLIMATE IN THIS INDUSTRY. WHAT I AM PARTICULARLY INTERESTED IN IS THE CHANGE IN THE PASSIVE-LOSS RULE FOR NON-CORPORATE TIMBER OWNERS. THE PURPOSE OF THE PASSIVE-LOSS RULE IS TO PREVENT PEOPLE FROM INVESTING IN LARGELY PASSIVE VENTURES (TAX SHELTERS) SOLELY TO OFFSET OTHERWISE TAXABLE INCOME. FOR MANY ACTIVITIES WHERE INCOME IS DERIVED IN THE SAME YEAR AS EXPENSES ARE MADE THIS MAKES SENSE. BUT TIMBER IS A LONG-TERM VENTURE. THE MONEY YOU SPEND ON

LAND IMPROVEMENTS AND DEVELOPMENT MAY NOT BE RETURNED UNTIL THE TIMBER IS HARVESTED 20 YEARS LATER. UNDER CURRENT TAX LAW THE COSTS DIRECTLY ASSOCIATED WITH STAND ESTABLISHMENT MUST BE "CAPITALIZED." THIS MEANS THAT SUCH COSTS CAN ONLY BE RECOVERED BY DEDUCTING THEM FROM THE INCOME THAT IS RECEIVED WHEN THE TIMBER TO WHICH THEY ARE RELATED IS CUT AND/OR SOLD, WHICH COULD BE 20 YEARS AWAY.

LADIES AND GENTLEMEN, MANY SMALL FARMERS AND INVESTORS CANNOT AFFORD TO DEVELOP TIMBERLAND UNDER THESE CONDITIONS. I DO NOT BELIEVE THE CONGRESS ADEQUATELY UNDERSTOOD THE RAMIFICATIONS OF THE ACTIONS WHICH THEY TOOK IN 1986. WHILE I AM NOT AN EXPERT IN TAX LAW AND THE MANNER IN WHICH IT CAN BE USED TO ENCOURAGE CERTAIN TYPES OF ECONOMIC BEHAVIOR, I CAN RECOGNIZE A LAW THAT DISCOURAGES ME FROM MAKING AN INVESTMENT.

THE CHANGE IN THE PASSIVE LOSS RULES FOR SMALL INVESTORS IS OF PARTICULAR CONCERN TO ME. MOST FARMERS CAN MEET THE MATERIAL PARTICIPATION RULES AND ARE NOT AFFECTED BY THE LIMITATION ON LOSS RULES OF THE 1986 TAX ACT. HOWEVER, MOST SMALL INVESTORS CANNOT MEET THESE PARTICIPATION REQUIREMENTS. IF THESE SMALL INVESTORS WERE NOT SUCH AN IMPORTANT PART OF THE ENTIRE TIMBER DEVELOPMENT INDUSTRY, THE LOSS OF THIS TAX

INCENTIVE WOULD NOT BE SO DAMAGING TO THE FUTURE HEALTH OF THE ENTIRE FOREST PRODUCTS INDUSTRY. OF THE APPROXIMATELY 150 MILLION ACRES OF COMMERCIAL FORESTS IN THE SOUTH, ALMOST ONE-THIRD IS HELD BY THE SMALL INVESTOR WHO HAS BEEN MOST SERIOUSLY AFFECTED BY THIS TAX LAW CHANGE. THESE 50 MILLION ACRES EQUAL THE ENTIRE ACREAGE HELD BY THE MAJOR CORPORATIONS OWNING LAND IN THE SOUTH. WE ARE NOW DISCOURAGING THESE PEOPLE FROM CONTINUING TO INVEST IN TIMBERLAND. THIS IS AN EXTREMELY FOOLISH POSITION TO TAKE AT THE VERY TIME WHEN WE ARE ALREADY HARVESTING MORE TIMBER IN THIS STATE AND IN THIS REGION THAN WE ARE PLANTING. AT SOME POINT IN THE NOT TOO DISTANT FUTURE THIS LACK OF FORESIGHT WILL CATCH UP WITH US AND WE WILL BE FORCED TO DEAL WITH SERIOUS SHORTAGES OF WOOD PRODUCTS AND RAPIDLY ESCALATING PRICES.

AGAIN, I AM GRATEFUL THAT SENATOR FOWLER HAS RECOGNIZED THE POSSIBLE CONSEQUENCES OF OUR PRESENT TAX POLICY. BOTH THE BUSH ADMINISTRATION AND SEVERAL MEMBERS OF THE CONGRESS HAVE DISCUSSED THE NEED FOR SOME TYPE OF REFORM IN CAPITAL GAINS TAXES. I HOPE THAT THE INFORMATION PRESENTED HERE TODAY WILL HELP IN THE DEVELOPMENT OF A POLICY THAT PUTS THE LONG TERM PRESERVATION OF THIS NATURAL RESOURCE ABOVE SHORT-TERM BUDGETARY CONSTRAINTS.

4

LC 7 7357

H. R. No. 349
By: Representatives Royal of the 144th, Greene of the 130th, Reaves of the 147th, Balkcom of the 140th, Holland of the 136th and others

A RESOLUTION

Relative to a long-term capital gains tax differential for the owners of timberland; and for other purposes.

WHEREAS, forestry is of vital importance to the economy of the State of Georgia because it annually contributes approximately $8.7 billion to our economy in forest products, salaries, and revenues and provides over 80,000 jobs for our citizens; and

WHEREAS, the private, nonindustrial forest landowner owns and controls 65 percent of the available commercial forest land in Georgia; and

WHEREAS, of Georgia's 23.7 million acres of commercial forest land, approximately 18 percent of these acres is considered nonproductive; and

WHEREAS, during the last five years in Georgia, an average of 640,000 acres have been harvested annually while an average of only 473,000 have been reforested annually; and

WHEREAS, the substantial excess of harvested acres over reforested acres will lead to an inadequate timber supply in the future; and

WHEREAS, forestry is an environmentally important industry in the State of Georgia, providing soil

stabilization, water purification, recreation, and fish and wildlife habitat; and

WHEREAS, in 1988, Georgia's forest industries announced planned investments of $1.4 billion in new construction, expansion, and modernization of their manufacturing facilities; and

WHEREAS, it is projected that by the year 2000 the South will have to produce one-half of the nation's wood resource needs; and

WHEREAS, in order to encourage reforestation, the long-term capital gains tax should be modified to provide a tax differential advantage for the owners of timberland.

NOW, THEREFORE, BE IT RESOLVED BY THE HOUSE OF REPRESENTATIVES that the members of the Georgia delegation to the United States Congress are urged to use their influence to achieve the enactment of a long-term capital gains tax differential which would have the effect of encouraging the owners of timberland to pursue a vigorous policy of reforestation.

BE IT FURTHER RESOLVED that the Clerk of the House of Representatives is authorized and directed to transmit a copy of this resolution to each member of the Georgia delegation to the United States Congress and to Honorable George Bush, President of the United States.

Senator FOWLER. Congressman Thomas.

Mr. THOMAS. Mr. Chairman, if I might. President Ewing, that was an excellent statement. I particularly liked your comments about this being a tax, capital gains being a tax on the environment and a tax on inflation.

As you know, the current proposals coming out of the administration are for corporate securities basically alone and do not include things such as forestry.

Mr. EWING. Yes, sir.

Mr. THOMAS. We all know the abilities of the American Farm Bureau and the farm bureaus across the States and the national organizations to aid and assist us on legislative need, and I encourage you, and I certainly hope that we can look for the forthcoming support of the American Farm Bureau to get timber included in any capital gains bill that comes along. I know that that will be your action.

Mr. EWING. Congressman Thomas, I have the pleasure of serving as a member of the board of directors of the American Farm Bureau Federation. We will be meeting in Chicago later this week, and you can rest assured that is an item that will be on the agenda, if it is not on there it will be placed on the agenda by his Georgia president.

Mr. THOMAS. Thank you, sir.

Thank you, Mr. Chairman.

Senator FOWLER. Mr. Ray.

Mr. RAY. I do not have any comments, Mr. Chairman. I just wanted to compliment Mr. Ewing on that excellent testimony and his effectiveness in bringing those statements into the record.

Mr. EWING. Thank you, sir. I appreciate the opportunity.

Senator FOWLER. Mr. Rowland.

Mr. ROWLAND. Thank you for a very excellent statement.

You made one comment that I want to expand on just a little bit dealing with the retirement system, timber as a type of retirement system.

Mr. EWING. Yes, sir.

Mr. ROWLAND. You know, the people in this country have one of the lowest saving rates of disposable income of any country in the world. We maybe save a little bit over 2 percent of our disposable income as compared to the Japanese, who save 17, 18 percent, and the West Germans, who save 14 or 15 percent. It seems we have a Tax Code that is not conducive to saving very much, and planting timber on land increases the value of that land it is a savings, and we need to do everything that we can to encourage that, and it seems to me—let me ask you this question. I read this somewhere, and I cannot recall offhand, do you know about how much the value of the land increases each year per acre for timber, for pine trees that are planted on it? Do you have any idea about that?

Mr. EWING. No, sir, I am sorry, I do not have that information.

Mr. ROWLAND. OK. I have heard that it really increases, and if you have land that comes on for 10 years it is worth a certain amount, and for 20 years it is worth even more than that, so I agree that it can be——

Senator FOWLER. We will have that information before the hearing is over. [Laughter.]

Mr. THOMAS. Mr. Chairman, if the gentleman will yield, I have those figures.

Mr. ROWLAND. I would like to have those.

Mr. THOMAS. It is roughly $50 a year for plantation pine in a good market area. You put a basic figure of about $300 on the raw land, and then you figure your cost of forestation, then you go at the rate of about $50 a year per acre of plantation. Is that not pretty close?

Mr. ROWLAND. That is an example of why it is so important for us to do everything that we can.

Thank you very much, Mr. Chairman.

Senator FOWLER. Thank you very much.

Brother Ewing, thank you.

Mr. HARDIN. Could I make a statement?

Senator FOWLER. I do not know. It depends on what you are running for. [Laughter.]

STATEMENT OF NAT HARDIN, FORSYTH, GA

Mr. HARDIN. My name is Nat Hardin from Forsyth, Georgia.

Senator FOWLER. Yes, sir.

Mr. HARDIN. I think Representative Thomas and Representative Rowland made a very fine point, and Mr. Ewing, about increasing the value of farmland and increasing the value of land, but I sit here and listen to a $50 an acre increase, and that is wonderful except that it does not take into account the costs that are not deductible by reason of the Tax Code, so you are not getting that increase.

In other words, you have to spend the money to make the land produce and be worth that extra $50, but you cannot recover that money until 20 or 30 years down the road, and I think that should be brought out in the record.

Senator FOWLER. Thank you, Mr. Hardin. It is and it is not. We will be discussing many such specific examples as we go to other panels, and though I would like to conduct this, sort of like a town meeting, I guess we had better stick pretty much to the formal presentations, and then we will have—I will ensure that we have a chance at the end to hear from members of the public who are here who have any additional comments or suggestions that we need to hear.

Mr. Ewing, thank you very much.

Let me say in conclusion again on behalf of all of us in Georgia we commend you on your new leadership, we look forward to working very closely with you and your staff, members of the Farm Bureau throughout the State as we actively work for better public policy in timber and the many other areas of farming that come under your jurisdiction and that of your membership, and if we can be of any help as we go forth in our efforts that is what we ought to be about.

Mr. EWING. Thank you, Mr. Chairman. I pledge to you all the support of the Georgia Farm Bureau. If we can help you, please let us know.

Thank you, sir.

Senator FOWLER. Thank you so very much.

Next we have a panel of three learned individuals, Mr. Bob Izlar, the executive director of the Georgia Forestry Association, Mr. John Mixon, the Director of the Georgia Forestry Commission, and Mr. Jack Warren, executive director of the Forest Farmers Association.

Gentlemen, if you will all join us here. Welcome.

I know that you are all experienced testifiers. Your complete statements, of course, will be made a part of the record, but we will be glad to hear from you and then have some time, with your brevity, for the panel to ask you some questions.

Mr. Izlar, would you like to start?

STATEMENT OF BOB IZLAR, EXECUTIVE DIRECTOR, GEORGIA FORESTRY ASSOCIATION, INC., ATLANTA, GA

Mr. IZLAR. Thank you, Mr. Chairman, members of the committee.

My name is Bob Izlar, I am executive director of the Georgia Forestry Association, Inc., headquartered in Atlanta, Georgia. Georgia Forestry Association is a private, nonprofit Georgia corporation whose primary objective is to promote the best interests of forest landowners, suppliers and consumers of wood fiber in the State of Georgia. The association encourages protection, management, utilization and marketing of forest resources within the State, as well as education and research relating to those resources. We work with association members, the Georgia General Assembly, State and Federal agencies and all other groups and individuals involved in this objective.

Our almost 3,000 members represent all facets of the forestry community: private forest landowners, foresters, State Forestry Commission personnel, U.S. Forest Service personnel, pulp and paper companies, solid wood products companies, loggers and log truckers, railroads, forestry equipment dealers, insurance companies, banks and many other businesses, organizations and individuals interested in forest conservation. In addition, Georgia Forestry Association manages the American Tree Farm Program in Georgia. Georgia is the largest tree farm State in the Nation with over 7.5 million acres under management belonging to over 4,000 individual tree farmers. Therefore, I believe it is safe to say we are a very broad-based forest conservation organization.

With that, I will diverge from the typed comments that I have, which I know will be made a part of the record, and I want to let you know what my real, personal concerns are here today, and it is that timber is a strategic national resource. I think this was well recognized in 1944 when we were involved in a two-front war and we had put tremendous strains on our timber resources, we realized that we were cutting more than we were growing, and that we had to do something about it. Capital gains treatment of timber taxation was the answer then, it is the answer now.

Despite the fact that we have nuclear missiles and we have Star Wars, we still have strategic national resources, and timber is still one of them. It is also a renewable resource, it is something that we can use over and over again, and as long as we practice sound forest management we can keep growing trees in this country.

When we do that, we get jobs, sure, and we get the economic impact and all that kind of stuff from it, but we also get some things that you cannot quantify a lot of times, like clean air and clean water and peace of mind when you go out in the woods fishing or hunting or just hiking, or just riding down the road and seeing a beautiful forest. Those things you cannot quantify, but those things are what timber also gives us.

The other thing I would like to talk to you about is our position in world trade. I am from Ware County, which is in the south part of the Eighth District, Congressman Rowland's district, and it used to be when we were growing up down in Waycross on the Okefenokee Swamp down in that part of the woods we were almost out of the State of Georgia, we were almost out of the world, and it really did not seem to us that what happened——

Senator FOWLER. Some say still are. [Laughter.]

Mr. IZLAR. We are proud of it, though.

Some people say it did not make any difference what happened in Berlin, it did not make any difference what happened in Vienna, it did not make any difference what happened on the trade floor in Tokyo. Well, it may not have then, but in Ware County today and every other county in this State and in this Nation it does make a difference what happens in London, it makes a difference what happens in Tokyo. I think we found this out with the stock market crash about a year and a half ago, all of a sudden everybody was waiting here to see what happened there before we knew what the business day was going to be like. International trade is here, the international community is here, and we are part of it whether we like it or whether we do not like it. Timber is our ace in the hole in international trade.

Worldwide we have had climate change. Look at Ethiopia and see what is happening there with the people who are starving, and what is happening to the land there. Ethiopia used to be a forested country; it is not now. Look at Lebanon, look at the Middle East, it used to be forested. Go back to the Bible, it talks about the Cedars of Lebanon and King Solomon's Temple. How many Cedars of Lebanon do you see on the NBC Nightly news? Not many.

The same thing is going to happen in tropical regions just south of us in the Amazon as day after day thousands of acres of tropical timbers are being cut and burned. Not necessarily cut and made into logs or something, but cut and burned for agriculture. That soil can take that kind of treatment for 1 or 2 years.

When you think about a tropical rain forest you think about the lushest, richest soil on Earth, and almost the opposite is true. The nutrients are in the trees, they are not in the soil, and when you take the trees away and you burn what is on top of it, the next big storm that comes along washes the soils away. It is just like what happened in this State and, Senator Pryor, in your State 100 years ago, 150 years ago when we had cotton cropping. You get a couple of years' crops out of it, you deplete the soil, you move on, and then your soil is left to wash away, your economy is left to wash away.

So we have all these things that are impinging worldwide, we have the climate, we have the soils, we have the infrastructure, we have the friendly political environment in this country to manage timber on an industrial basis. We can compete in the world com-

munity, and we can compete well. It is not like steel where we have lost our initiative, it is not like automobile manufacturing where we have lost our initiative, we have initiative and we can keep it.

But the thing that bothers me most is that the government's fiscal policy is encouraging deforestation in this country, and it is not encouraging reforestation. The capital gains was put on timber for a realization of strategic national resources, also a realization that it is not like a soybean and it is not like a chicken. It is a crop, yes, but it is a crop that takes 20, 25, 35, 45, 50 years to mature, depending on the end use that you are trying to get out of that crop. During that time you can have all sorts of what are called acts of God—a whole lot of things are blamed on that fellow—but hurricanes, fire, insects, disease, ice storms can come through. You take an 8-year-old pine plantation in this area right here, it is very susceptible to ice storms, very susceptible to Southern pine beetles, very susceptible to fire. If any one of those, or all of those happen, say in the eighth year, then that tree farmer has lost 8 years of his investment, he has lost 8 years of opportunity cost that he could have put into a CD or a T-Bill or something else. He cannot go back and get that back.

A cotton farmer can come back later—if he loses the first year he has lost 1 year's opportunity. Yes, that is a big loss for him, but if you ask a cotton farmer could he stand 8 years of the loss of opportunity cost he would probably tell you he would go out of business. And the same thing is true with timber. The risks are another reason why we need capital gains treatment.

The other thing that is discouraging to tree farmers is that when they go out and they manage their land in many cases they are elderly, they are out of State, they are not able to get out in the woods and do all the work themselves, they either have friends or they rely on the Forestry Commission, or they rely on industry, or they hire consultants to help them manage their timberlands. They cannot under the proposed IRS rules and passive activity losses deduct annual management expenses. That is like telling a homeowner you can buy a house and you can pay $100,000 for it, but you cannot deduct your annual mortgage interest payments until you sell that house. How many folks would buy a house if they had that true? That is the same thing that you are telling tree farmers with these passive activity losses.

Both of these things combined are what we believe are a discouragement to tree farmers in the form of government fiscal policy that actually, in our opinion, encourages deforestation and not reforestation, and anything that you gentlemen can do to help us to remedy the situation would be greatly appreciated.

Thank you, sir.

Senator FOWLER. Thank you, Mr. Izlar. [Applause.]

[The prepared statement of Mr. Izlar follows:]

STATEMENT OF GEORGIA FORESTRY ASSOCIATION
SENATE TAX HEARINGS
MARCH 13, 1989 - MACON, GEORGIA
BOB IZLAR
GEORGIA FORESTRY ASSOCIATION - ATLANTA, GEORGIA

My name is Bob Izlar. I am Executive Director of the Georgia Forestry Association, Inc. headquartered in Atlanta, Georgia. Georgia Forestry Association is a private, non-profit Georgia corporation whose primary objective is to promote the best interests of forest landowners, suppliers and consumers of wood fiber in the State of Georgia. The Association encourages protection, management, utilization and marketing of forest resources within the state, as well as education and research relating to those resources. We work with association members, the Georgia General Assembly, State and Federal agencies and all other groups and individuals interested in this objective.

Our almost 3,000 members represent all facets of the forestry community: private forest landowners, foresters, State Forestry Commission personnel, U.S. Forest Service personnel, pulp and paper companies, solid wood products companies, loggers, log truckers, railroads, forestry equipment dealers, insurance companies, banks and many other businesses, organizations and individuals interested in forest conservation. In addition, Georgia Forestry Association manages the American Tree Farm Program in Georgia. Georgia is the largest Tree Farm state in the nation with over 7.5 million acres under management belonging over to four thousand individual Tree Farmers. Therefore, I believe it is safe to say we are very broad-based forest conservation organization.

Georgia Forestry Association has long held an interest in forestry taxation matters on the federal, state and local level. In particular, GFA has long been involved in the campaign to keep timber capital gains treatment of timber. We were a member of a coalition which sought to keep timber capital gains treatment for timberland owners in 1986. We support the restoration of long-term timber capital gains treatment for forest landowners, both coporate and private. In addition, we fully support the ability of forest landowners to continue to be able to deduct forest management expenses on an annual basis.

Over 66% of the state of Georgia, or 24 million acres, is in commercial forest land. Forestry is Georgia's biggest industry, and it contributes nine billion dollars annually to the economy, as well as employing

80,000 people. Georgia is blessed with the climate, soil and infrastructure to compete globally in the forest products market.

"Global warming, the greenhouse effect and tropical deforestation" have become household terms recently. If we are to maintain environmental balance and protect the health of the planet and its inhabitants, then significant international steps must be taken by world governments to stop and reverse environmental degradation. While this is a lofty ideal, the practicality of the matter is that it probably will not happen any time soon. This means that a considerable protion of tropical forests will be destroyed by the end of the century. Couple that with changing weather patterns and the projected world demand for forest products will have to be carried by a much smaller resource base. Many experts point out that the U.S. South will face incredible pressure to take up the slack in reduced world timber supply. Obviously, Georgia will have the opportunity to significantly enhance its international economic position, if it is able to increase forest productivity.

The recently published report of the U. S. Forest Service, "The South's Fourth Forest": Alternatives for the Future", indicates that the United States demand for wood fiber will more than double by the year 2030. The South produces over 50% of the nation's wood needs today, with more pressure on wood supply in the future. However, the report shows that annual timber growth for softwoods has leveled off in some areas and declined in others. More softwoods are being harvested that are being grown over large areas in the South. Now, if you add back in the very probable fact of increased international demand with the already predicted doubling of national demand, where will the wood come from?

Timber growing is a long-term investment with its substantial risk for fire, insects, disease, storms and other natural occurances. If a cotton farmer loses a crop to drought this year, he can replant next year without a significant loss in opportunity cost. However, a tree farmer growing sawtimber on a 45 year rotation faces a different situation. For instance, suppose a pine beetle outbreak, hurricane or forest fire destroys this tree farmer's crop in its eighth year. None of that timber will be merchantable, which means the landowner must pay to have the land cleared of the useless trees and replanted. This will be done at tremendous cost plus the eight years of opportunity cost which will have been lost.

Forestry is also vital to wildlife enhancement, water quality, aesthetics and recreation. Reforestation also plays a vital role in efforts to combat the "greenhouse effect". At the same time, the land is growing the future supply of wood for jobs and America's homes.

It seems that government fiscal policy is discouraging investment in a strategic national resource. Now, with net capital gains taxed at the same rate as ordinary income, many private landowners feel betrayed by the government because timber growing is a long-term investment. The loss of capital gains provisions has, in effect, doubled capital gains taxes for timberland owners, which means less money available to replant after harvest. A large number of these timberland owners are not going to continue to manage for long-term yields. It seems logical that the change in capital gains rates will result in a lack of forest regeneration which will lead to even more pressure on timber supply, especially in Georgia. This fiscal disincentive to individuals and corporations could devastate the nation's timber supply. There is no way timber from the National Forests can meet the demand. A capital gains tax rate deferential for long-term timber growing investment is essential to encourage private investment in this long-term enterprise which has substantial start-up and maintenance costs.

The loss of tax incentives is affecting our ability to compete in foreign wood markets. Japan, Taiwan and European countries are pushing us out of the international market place. One of the main reasons they are doing well is they don't tax capital gains on timber. Our government has put us at an unfair advantage while these other countries are willing to take the risk necessary to grow trees commercially. But if we could compete on an even footing, there is no way they could produce the volume and quality of timber we could.

Another serious disincentive posed by government fiscal policy are the regulations growing out of the passive activity loss provisions of the "Tax Reform Act of 1986". Before that, timberland owners had been able to annually expense legitimate management and carring costs associated with timber growing. Now, it seems that the proposed IRS rules will not allow landowners to do this annual expensing. An arbitrary "number of hours" test to qualify as an active participant in a trade or business does not fit the business of growing trees and was not the intent of Congress to do so. This is just like telling a homeowner that mortgage interest expense cannot be deducted on an annual basis any more, but it can be deducted when the house is sold. Sound illogical? Certainly! Timberland owners see it the same way.

The Congress needs to take a long, hard look at the role forestry plays in the American economy. It needs to recognize that timber is a strategic national resource. Every effort should be made to enhance the fiscal incentives for timber growing.

Senator FOWLER. Before we go to our next witness, joining us now is another very fine member of the Georgia congressional delegation. In fact, I know from personal experience that Atlanta has had some excellent Congressmen—but the present one is the best of the whole tradition. We welcome Congressman John Lewis from Atlanta.

Mr. LEWIS. Thank you. [Applause.]

STATEMENT OF HON. JOHN LEWIS, A REPRESENTATIVE IN CONGRESS FROM THE FIFTH CONGRESSIONAL DISTRICT, STATE OF GEORGIA

Mr. LEWIS. Thank you very much, Senator Fowler.

I want to take this opportunity to thank you for hearing the testimony of these witnesses gathered here today concerning the tax issues facing Georgia tree farmers and the timber industry.

Senator Fowler, and other members of the subcommittee, I have a prepared statement, and since I am so late I would like to submit that statement for the record.

Senator FOWLER. Without objection.

[The prepared statement of Congressman Lewis can be found on page 7.]

Senator FOWLER. Our next witness is a very knowledgeable man with a fine public record in forestry, Mr. John Mixon, Director of the Georgia Forestry Commission. We welcome you, sir.

STATEMENT OF JOHN W. MIXON, DIRECTOR, GEORGIA FORESTRY COMMISSION, MACON, GA

Mr. MIXON. Thank you, Senator Fowler, Senator Pryor, and other members of the Georgia congressional delegation.

We are delighted to have you here today and to have this opportunity to share our growing concern with you over the future of forestry in Georgia.

Georgia is one of the Nation's leading forestry States with 23.7 million acres—a State in which more than 100,000 timberland owners are beginning to feel the crippling effect resulting from the present U.S. Tax Code pertaining to forested property.

The change in the allowable tax deduction could not have come at a more crucial time for those of us who depend on trees as a profitable and renewable crop. It could not have come at a more crucial time for the forest industry that depends largely on the thousands of small, private landowners for a steady stream of raw forest material.

Forestry in Georgia annually generates more than $8.7 billion and provides employment for more than 80,000 men and women. Six new major wood-using manufacturing plants are now under construction in the State, and more are considering a move to Georgia if we can assure them of an ample supply of wood.

If the private landowners—and that includes the serious tree farmer who has most of his holdings in trees as well as the farmer who supplements his row crops and pasture by growing timber on a small portion of his land—are discouraged by the loss of the tax incentives, it will become increasingly difficult to convince them to replant after they harvest their timber.

I have talked to corporate executive officers of major plants locating in Georgia, and they tell me that the foremost reason for locating their plants in our State is the availability of timber—the abundance of wood that is vital to their operation.

The new forest-related industries that are being established within our borders and the expansion and modernization of existing plants represent more than $2.4 billion. In fact, 45 percent of the capital investments announced in Georgia in 1988 were forest-related investments.

We planted more trees in Georgia during the past 5 years than did any other State. In fact, we set a world record last year by planting 603,000 acres—and when I say we, this is the total forestry community—but when we turn to recent surveys, it is clearly evident that we are harvesting more pine timber than we are growing each year.

At the present time we are conducting the U.S. Forest survey in our State to determine exactly what our timber supplies are out there. These comprehensive timber resource surveys show that timber removal is exceeding growth. Of the three survey units completed to date—that is Southwest, Southeast Georgia, and I have some preliminary data on central Georgia—pine volumes harvested on private land holdings exceeded growth by more than 28 percent.

Average annual removals of pine in southwest Georgia exceeded net growth by 11 percent. Southeast Georgia was 2 percent overall, harvest over growth, but when you talk about the private landowner, southeast Georgia is where we have more major forest industries than anywhere in the State. We had a 34 percent over-cut there when you talk about growth and removal on the private forest landowners in southeast Georgia. The central Georgia data is not complete, but the preliminary data indicates we are harvesting 24 percent more pine timber in middle Georgia than we are growing at the present time.

Senator FOWLER. And that is, despite those figures, does that include the increased plantings allowed under the Conservation Reserve?

Mr. MIXON. Yes, sir. The Forest Service survey does not take into account that volume until the tree gets 5 inches in diameter, but since you mentioned the Conservation Reserve Program, as you know we have planted 530,000 acres so far under that program. If it had not been for the Conservation Reserve Program we would have had real problems here in our State. The removal of pine timber is certainly exceeding growth on the private landowners' property. Industry is doing a pretty fair job on most of their holdings.

The high removal-to-growth ratio, especially in pine, must be reversed if we are to meet the future demands of our forest industries. If the overall inventory continues to decline, timber prices will surely rise and encourage substitute products to become more competitive. A recession in the forest industry would gravely affect the State's general economy.

The removal of the 60 percent exclusion on capital gains income has indeed made timber a less attractive investment, especially on cutover sites where high initial costs are required for reforestation.

The passive loss rules now makes it almost impossible for many landowners to qualify for tax deduction of annual timber management costs. This discourages good timber management practices and could ultimately cause a serious decrease in both quality and quantity of timber.

Our foresters with the Forestry Commission and other foresters across the State are finding that many landowners are expressing an unwillingness to replant trees after a timber harvest, as a result of the loss of the capital gains deductions. In some instances, those who are planting are curtailing some important management programs because of the passive loss rules.

Remember, this trend is cause for grave concern because approximately 75 percent of the timber we harvest each year comes from the private landowner.

Let me emphasize that again. Three out of four of those trucks you see going up and down the road, three out of four of those rail cars you see going along the rail tracks are coming from the private landowners' property. 75 percent of the timber we harvest is coming from the private landowners 'property, and only about 25 percent from industry and government land.

Gentlemen, you are aware that a well managed forest improves water quality. A well managed, multiple-use forest promotes wildlife habitat and scenic, well-tended forests are used for recreational purposes annually by hundreds of thousands of our citizens and visitors to our State.

The National Association of State Foresters, which I also represent here today, is promoting a nationwide forest stewardship program that encourages these aspects of forest management.

I have discussed this with part of our Georgia delegation, and I certainly plan to be discussing it with you other gentlemen soon.

Senator Fowler, we appreciate your holding this subcommittee hearing in Macon. Please continue your effort to give the forestland owner an incentive to manage his forest and regenerate every acre after a timber harvest. Our forests are our greatest renewable natural resource, and if managed correctly we can harvest, regenerate and harvest again, while providing timber, clean air, abundant wildlife, aesthetics and clean water.

Thank you again, Senator Fowler, for your interest in forestry—Georgia's largest industry.

Senator FOWLER. Thank you, John, very much. [Applause.]

The last witness on this panel is another undisputed expert from the forestry field. We are very pleased to have Mr. Jack Warren, the executive vice president of the Forest Farmers Association.

STATEMENT OF B. JACK WARREN, EXECUTIVE VICE PRESIDENT, FOREST FARMERS ASSOCIATION, ATLANTA, GA

Mr. WARREN. Thank you, Senator Fowler and, Senator Pryor, we are real glad to have you over this way, and other Members of the Georgia delegation:

I must say it is certainly a pleasure to come to Macon rather than going to Washington, DC. Is not this a pretty place to be.

Senator FOWLER. Jack, that is not what you said when you were in Washington. [Laughter.]

Mr. WARREN. I did not say anything about the nightlife. [Laughter.]

My name is Jack Warren, and I am executive vice president of the Forest Farmers Association, an organization composed of private timberland owners, both large and small, concentrated in 15 Southern States who own or manage some 40 million acres of timberland. Our association is headquartered in Atlanta, Georgia and I appreciate the opportunity to testify.

My statement is directed toward the detrimental effects of the Tax Reform Act of 1986 on private timberland owners and what restoring certain provisions in the act would mean to wood supply in the South. Especially, and more particularly, as far as the capital gains and the passive activity loss rules are concerned.

As you know, Senator Fowler, the forest products—and I do not think I have to reiterate this—are certainly heavily dependent, the industry is heavily dependent on the private individual in the various States in the South, and particularly the 15 States that we represent.

This raw material base is certainly something that the forest industries cannot provide themselves. Of the 122 million acres in the South—and this is commercial timberland—60 percent of that is owned by private individuals, and these are the people that we are talking about here today that we are concerned with.

Even more so we are concerned with the fact that the new survey that was done by the U.S. Forest Service, and John has alluded to some of this, not only shows that the South produces 50 percent of the Nation's woods needs, a fact that many were not aware of, but it shows that in some areas we are actually cutting more timber than we are growing, and John mentioned that, in south Georgia, probably a perfect example of this.

The new tax laws are not helping us a bit in this area, and it certainly is a disincentive for regenerating land. I think if you were in a business and you had the unfavorable tax laws that the timberland owner has, you would look at something else to get into. I know I certainly would.

I know something that is really important, I know you had a hearing last year, Senator, on the Conservation Reserve as far as tree planting is concerned. These tax laws are counterproductive to the Conservation Reserve Program because it is simply a disincentive for people to plant trees. It does not matter whether you get a subsidy or not, the tree farmer knows that somewhere down the line he has to sell these trees, and he has to declare that income as ordinary income, so for a long-term investment he sees that as a disincentive making it counterproductive to our fine Conservation Reserve Program.

The reinstatement of the tax incentives would be good conservation and environmental sense, as Bob has already mentioned. Good forestry practices are vital to wildlife enhancement, water quality, aesthetics and recreation and timber supply, and that is the beautiful part about the whole thing is that we can not only supply timber, but we can certainly utilize the land in itself.

The only time I was ever quoted in the Wall Street Journal, I talked with this guy for about an hour, he was a reporter, and I was trying to think in my mind "What can I tell this guy to make

it sound like timberland is a tremendous investment?" I told him, "Well, you cannot hunt and fish on stocks and bonds," and that is the only thing he quoted me on. [Laughter.]

The Forest Farmers Association requested Drs. Coleman Dangerfield and John Gunter, with the University of Georgia, Cooperative Extension Service, to take a look and see if they could come up with some figures and some numbers for us to publish an article in our magazine ["Forest Farmer"] on how the Tax Reform Act of 1986 effects timberland ownership. I have copies of the "Forest Farmer" magazine if any of you would like to see it later on.[1]

But to make a long story short, in essence what they said, and something that we suspected was that income from tree production has been reduced tremendously. The loss of capital gains provisions along with the passive loss regulations, the effects of that, tree farmers will try to minimize their losses, which I think any good businessman will do, and to minimize the loss probably the most expensive thing that they have is regeneration and replanting those trees, and that is money up front, and they simply will not do it, they just will not do it because that is a tremendous expense for them.

The study concludes that if profitability cannot be restored by reducing costs, then the tree farmer will not harvest these lands and will not reinvest, he will start looking at other ways to invest his money in CDs or Treasury bills which guarantee a return with little risk involved.

The loss of tax incentives for timberland owners, which has already been mentioned, is certainly affecting our ability to compete in the world market, and timber is a world market commodity now. It is not just south Georgia, it is not just the Southeast or the United States, it is the world market, and we compete with those countries that give a capital gains break on their timberland investment, just as we competed with Canada when the Canadian Government was giving the trees to the sawmillers and it was very difficult for us to compete, and thank goodness the Federal Government did something about this. This is certainly an unfair advantage to us.

CAPITAL GAINS PROVISIONS

As far as the capital gains is concerned, it has already been mentioned that this was basically a conservation measure in 1944 because we were not replanting our trees. Since the 1944 inclusion of capital gains for timber the history has already been written, we had a tremendous success in reforestation and regeneration, but now net capital gains is taxed as ordinary income and the order is reverting back to pre-1944 conditions.

One forest farmer in Stewart County, Georgia, called me the other day and he says "If you get a chance, tell them what I want them to hear." He says "I cruised my timber for a thinning and sent out a number of bids to forest products companies. The highest bid was 25 percent lower than I felt the timber was worth. Then my accountant figured that taxes on the sale would be twice

[1] Copies of the "Forest Farmer," January 1988 issue, are retained in the subcommittee file.

as much without capital gains provisions. For the first time in 25 years, I decided on a poor forest management practice—do nothing!"

PASSIVE ACTIVITY LOSS REGULATIONS

As far as the passive activity loss regulations are concerned, the material participation tests published by the Internal Revenue Service are extremely unfavorable and really hurt us and it is unfavorable as far as timberland owners are concerned. The IRS, as we testified last June before the IRS, they came up with these arbitrary hours that I do not think Congress intended for them to do, and this is absolutely killing us because timber is so unique. Some years you do put in 100 or 500 hours; other years it does not require that many hours to maintain what you have. If you are planting trees or if you are harvesting trees, sure, you are going to put in more hours, but that 20-year span in between you do not put in that many hours, so by not being allowed to write-off annual expenses is a tremendous detriment to our timberland owners, and thank goodness we have the forethought of the Forestry 2000 Task Force and H.R. 1068, which I hope we can get through and get passed, and I hope that, Senator, you or your colleagues will consider a companion bill in the Senate.

A certified public accountant in middle Georgia, and as far as the passive activity loss rules are concerned this is what he said: "The group of people that will be hurt the worst by these regulations are the people who are doing the most intensive management. My mother is 75 years old and my father is 83, and they certainly would not be able to go into the woods for at least 500 hours a year and work their timberlands. They currently prepare the annual budget for their timberlands, and have a forester perform all practices which are recommended. I certainly could not see them in the woods doing controlled burning, injecting cull hardwoods or operating chain saws to cut out beetle spots. If they could not deduct annual expenses, they probably would stop all management practices."

Mr. Chairman, we certainly appreciate your concerns on the effect of the new tax laws on timberland owners by holding this hearing and getting the firsthand true facts. Our membership applauds your foresight in recognizing the need for this hearing.

Thank you very much.

Senator FOWLER. Thank you. [Applause.]

[The prepared statement of Mr. Warren follows:]

Statement to
Conservation and Forestry Subcommittee
Senate Agriculture Committee
Public Hearing - Macon, Georgia

by
B. Jack Warren
Executive Vice President
Forest Farmers Association
March 13, 1989

Senator Fowler, Senator Pryor, other committee members and distinguished Congressmen from Georgia, my name is Jack Warren, and I am executive vice president of Forest Farmers Association, an organization composed of private timberland owners concentrated in 15 southern states who own or manage some 40 million acres of timberland. Our association is headquartered in Atlanta, Georgia and I appreciate the opportunity to testify.

My statement is directed towards the detrimental affects of the Tax Reform Act of 1986 on private timberland owners and what restoring certain provisions in the act would mean to wood supply in the South.

As you know, Senator Fowler, the forest products industry in the South depends heavily on private timberland owners (forest farmers) for its raw material base. The industry has a tremendous impact on the economy of the South, being the number one industry in over half of the southern states (including Georgia) and ranking second or third in the others. Of the 122 million acres of commercial timberland in the South, forest farmers own over 60 percent of these lands. The U.S. Forest Service predicted, in a recent study, that demand for wood would double by year 2030 nationwide. The South already produces over 50 percent of the U.S. wood needs today and more pressure on wood supply is expected in the future. The report also shows that net annual timber growth for softwoods has leveled off in some areas and declined in others. The new tax laws are creating a disincentive for timberland owners to regenerate their lands which will add even more pressure to timber supply.

The new tax laws are counterproductive to the highly successful tree planting portion of the Conservation Reserve Program, as well as several other federal programs aimed at reforestation. Forest farmers are hesitant to make commitments to long-term investments in tree planting considering all the risks involved -- fire, disease, drought, etc., after being stung by these tax laws. One of our members told me last week, "Congress sold me a pig in a poke when they led me to believe that I would be able to benefit tax wise if I committed to planting trees 15 years ago. Now it is time to thin those trees and I have to treat the sale as ordinary income. I don't think I will make that mistake again."

Reinstatement of tax incentives also makes good environmental and conservation sense. Good forestry practices and reforestation are vital to wildlife enhancement, water quality, aesthetics and recreation. Reforestation also plays a vital role in efforts to combat the "greenhouse effect" as well as supplying our increasing demand for wood products. In essence, we are "renewing America's natural resources -- trees, water, wildlife, aesthetics and recreation."

Forest Farmers Association requested Drs. Coleman Dangerfield and John Gunter, with the University of Georgia Cooperative Extension Service, to develop an article for Forest Farmer magazine on how the Tax Reform Act of 1986 affects forestry income. As suspected, the study found that income from tree production has been reduced drastically in the South. With the loss of capital gains provisions, along with the passive loss regulations, forest farmers will try to minimize losses by lowering cost of timber management. Tree planting being the most expensive management activity will be eliminated first.

The study concludes that if profitability cannot be restored by reducing costs, many timberland owners will harvest trees and will not reinvest in a new crop through regeneration. Some forest farmers will sell their tree-growing assets and put their money in investments such as CDs and Treasury Bills that have guaranteed returns without the risks involved in growing trees.

The loss of tax incentives for timberland owners is affecting our ability to compete in foreign wood markets. Japan, Taiwan and the European countries are really hurting us in the international market place. One of the main reasons these countries are doing so well is because they don't tax capital gains on timber. They have an unfair advantage and are willing to take the risks necessary to grow trees commercially because of the favorable tax laws.

Capital Gains Provisions

In 1944, capital gains treatment for timber sales was enacted by Congress in sections 631(a) and 631(b) of the Internal Revenue Code as a conservation measure. For some 20 years before 1944, capital gains treatment was allowed for timber sales only if it had been held as an investment and not as a trade or business (similar to President Bush's proposal). During this time many timber owners liquidated their trees and neglected to replant. Since 1944, there has been a dramatic increase in reforestation and sustained timber management. In fact, a 20 percent increase in harvests resulted in the first 5 years following the 1944 reform, with a steady rise in reforestation.

Net capital gain is now taxed as ordinary income. Many private landowners are not going to continue to manage for long-term yields. The order is reverting back to pre-1944 conditions.

A forest farmer in Stewart County, Georgia called me last week with a good example of the attitude among tree growers. "I cruised my timber for a thinning and sent out a number of bids to forest products companies. The highest bid was 25 percent lower than I felt the timber was worth. Then my accountant figured that taxes on the sale would be twice as much without capital gains provisions. For the first time in 25 years, I decided on a poor forest management practice -- do nothing!"

Mr. Chairman, timberland owners need and deserve a capital gains differential to continue long-term commitments with substantial risks in order to have more money available to replant after harvest. We would appreciate your support in this effort.

Passive Activity Loss Regulations

The material participation tests published by the Internal Revenue Service are extremely unfavorable to timberland owners because of the nature of activities associated with timber management. The arbitrary "hours tests" does not fit in the activity of managing timberland. Timber is a unique crop, unlike row crops. Trees take several decades to reach merchantable size before any income is realized; therefore, income is deferred by nature of the business and not by choice. The timberland owner, however, does incur annual expenses during this period of time and should be allowed to write-off the expenses when they occur. Timber management does not require a certain number of hours to be an "active owner." It will require more time during certain years, as when planting and harvesting, than at other times. Timberland owners should be classified as "active participants" when they make all significant decisions in the business or when they do most all of the work necessary to do the job.

A certified public accountant in middle Georgia wrote, "The group of people that will be hurt the worst by these regulations are the people who are doing the most intensive management. My mother is 75 years old and my father is 83, and they certainly would not be able to go into the woods for at least 500 hours a year and work their timberlands. They currently prepare an annual budget for their timberlands, and have a forester preform all of the practices which are recommended. I certainly could not see them in the woods doing controlled burning, injecting cull hardwoods or operating chainsaws to cut out beetle spots. If they could not deduct annual expenses, they probably would stop all management practices."

Mr. Chairman, our association was very much involved in promoting H.R. 1086, "Farm and Woodland Owners Tax Simplification Act of 1989," which was recently introduced in the House by the four co-chairmen of the Forestry 2000 Task Force. We urge you to develop a companion bill for the Senate. This bill would solve the detrimental effects of the passive loss regulations on timberlands owners.

Thank you, Mr. Chairman, for being concerned about the effects of the new tax laws on timberland owners and calling this field hearing to learn "first-hand" the true facts. Our membership applauds your foresight in recognizing a need for such a gathering.

Senator FOWLER. Senator Pryor.

Senator PRYOR. Yes. I think this panel, as with all of our witnesses today, have been very, very informative, educational and instructive.

I would like to just make a short statement, and then ask for a little additional information to be inserted in the record at the appropriate time.

All of us at this table deal in a world of perceptions. For example, when we go back to Washington this afternoon and tomorrow we start talking to our colleagues about changing the capital gains tax, most of them are going to say "Yeah, you fellows want to protect those rich people." That is what they think about it, that is a perception.

You deal in a world of reality here. Somehow or another we have to translate the world of reality and the world of practicality to some legislation, some changes that are going to correct a very bad situation.

The other thing is when we talk about the timber industry many people in Congress who have no relationship to the timber industry will say "Oh, you all are just trying to help out that big old corporation, Georgia Pacific or International Paper in my home town, or Weyerhaueser, or some of these big timber giants. That is what you all are trying to do."

Somehow or another the fact that there are the timber farmers as Jack has talked about, the 83-year-old parents and 70-year-old parents, somehow or another that is not getting through, so it is the perception that we have to deal with.

I would like to ask this—and it may, Jack, be covered in that brochure, I have not seen that—I would like if maybe the three of you could get together where we could show some dollars and cents and not too much theory, maybe a Mr. and Mrs. John Jones, Route 3, Macon, Georgia on a 40-acre or 80-acre piece of ground where they have harvested and worked with that acreage for a number of years, what the passive loss has done to that, what the capital gains change resulting from the 1986 tax law, the IRS deduction of expenses, et cetera, make sort of a model for us that we might be able to take back and say "Here is what it is costing Mr. and Mrs. John Jones, and here is why they are not going to replant," and I think that would be helpful for us to be able to take back, and if Senator Fowler will leave the record open for a few days maybe we could get that made a part of the record so we could use it with our colleagues.

Mr. WARREN. We can do that.

The material follows:

Georgia Forestry Commission

JOHN W. MIXON
DIRECTOR

BOX 819 MACON, GEORGIA 31298-4599

April 27, 1989

WHAT THE TAX REFORM ACT OF 1986 HAS DONE FOR THE AVERAGE LANDOWNER

A landowner owns 50 acres of timberland with a timber value of $35,000. His basis, or original investment in the timber, is $10,000. (Basis originates when timberland is (1) purchased, (2) reforestation expenses are incurred, or (3) timber is inherited.)

A comparison of this landowner's tax liability from a timber sale, prior to the Tax Reform Act of 1986 and after the Act, follows. For purposes of this example, it is assumed that the landowner incurred expenses of $500 in advertising and legal fees necessary for the sale. He is also assumed to be in the 28% tax bracket.

BEFORE T.R.A. OF 1986		AFTER T.R.A. OF 1986	
Sale Price	$ 35,000	Sale Price	$ 35,000
Less Basis	-10,000	Less Basis	-10,000
	25,000		25,000
Less Cost of Sale	- 500	Less Cost of Sale	- 500
	24,500----------TAXABLE GAIN----------24,500		
Less 60% Capital Gain Exclusion	-14,700		
	9,800---------AMOUNT TAXED AT ORDINARY RATE--------24,500		

.28 x 9,800 = $2,744----------DUE IN TAXES----------.28 x $24,500 = $6,860

In this example, the loss of the capital gains exclusion under the TRA of 1986 cost this landowner $4,116 on a $35,000 timber sale.

LBH:fcc

JIM L. GILLIS, JR., Chairman, Soperton
T. FELTON DENNEY, Carrollton
ELEY C. FRAZER, III, Albany
GLORIA SHATTO, Mount Berry
ROBERT SIMPSON, III, Lakeland

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Senator PRYOR. Thank you.

Mr. MIXON. Senator Pryor, I think one of the people who will testify a little later today, Mr. C.M. Stripling, is going to do exactly what you requested.

Senator PRYOR. Very good.

Mr. MIXON. We can certainly do what you are asking. We can get other examples of smaller landowners with smaller acreages than Mr. Stripling.

Senator PRYOR. Thank you.

Mr. THOMAS. Mr. Chairman, if I might just make a small comment here, in reference to a very good point that Mr. Hardin brought out earlier in the hearing, a while ago, in using this figure of $50 an acre. I was doing it to support my colleague Congressman Rowland's comments, of course, that we need to encourage savings, here was an excellent vehicle.

I have one of these letters—I have also seen Mr. Stripling's letter and heard a great deal from him in the past, but I have a letter from a small landowner in Bulloch County. I will not go through the letter, I am submitting it for the record.[2] Senator Pryor, it does just what you were talking about in the case of the capital gains, but just let me, to clear this idea, for the members of the press that might be here and for the record that might think that you get $50 an acre and it is a free ride and 20 years later you have yourself a $1,000 gain.

This gentleman wrote me a letter, specific as we are looking for, on the purchase of 173 acres of woodland that was bought in 1962 for $100 an acre. We know today you could not buy land for less than probably $300 an acre. He got his planting cost down to $75 an acre by some help through USDA's Conservation Program and ACP Program, which we all know is basically ineffective today and no funds available, got his cost down to $75 an acre, which realistically is between $175 and $200 today. Even with those low costs of his land and the low cost of planting that land, at the end of his harvest time, 20 years in which he is ready to sell some of his timber, a little over 20 years, he comes up with a 6½ percent return, but points out clearly if he had his own labor and his own equipment paid for, which he did himself, he would be in the negative column here, and so if you look at today's cost realistically he has used the same market price with far less input. What it says is there is absolutely no incentive as an investment with the loss of capital gains for a small individual owner to own a plot of land and commit it to timber. That is basically what the letter states in clear figures, and this will be submitted to the record.

Senator FOWLER. To put these figures in perspective, Mr. Mixon, if the tax changes, if we reimplement the capital gains treatment and the passive loss treatment for family farmers, would that be enough to offset the figures that you gave us, the 35 percent cuttings over plantings?

Mr. MIXON. Senator, it would help.

I have some data out at the registration desk indicating that we are harvesting about 200,000 acres per year in the State of Georgia

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[2] The letter of E.T. Mullis, Statesboro GA, can be found on page 20.

that is not being planted back. The landowners are cutting pine timber at about 200,000 acres per year that is not being regenerated.

Congressman Thomas referred to the ACP Program. Another Federal program is the FIP Program, the Forest Incentive Program. We get about $1 million per year here in the State of Georgia, but we have a request for about $17 million. There are that many people, if you had the money, who would participate in this program.

No, sir, the capital gains alone is not going to do it, but capital gains will help.

As I stated earlier, we planted 603,000 acres last year. For the past 5 years, we have planted more acres of trees in Georgia than has ever been planted in any State anywhere, but we are harvesting more timber. Capital gains will help, but, no, sir, it will not be the answer to the total picture.

While I have an opportunity to comment here on the Conservation Reserve Program, we would certainly like to see marginal pasture land become eligible under the Conservation Reserve Program. When soybeans go to $8 and $10 per bushel, if you are a real farmer you do not think about planting pine trees on marginal cropland, you are going to put soybeans out there. The reinstatement of capital gains would certainly help, there is no question, but, no, sir, it will not be the total answer.

Senator FOWLER. As we address, and we are going to, to the farmers in our next panel coming up here, it will be helpful—I mean the whole bottom of all of this, my phrase here, I just thought of it when I listened to Mr. Izlar, and I appreciate his comments on the national strategic value of our forests, we in this country are the OPEC of trees. We are the OPEC of the world if we have got sense enough to maintain that forest on what we call a sustainable basis.

For us laymen that is very simple, simply there ought to be a tree planted, at least one for every one that is cut, and it would be a tremendous help to all of us on this panel if we get suggestions on how we reach that. It is not just tax changes, a broad perspective of how we reach that goal of sustainability so we maintain always the incredible forest reserves and at the same time our industry moves forward. That is the goal of our national policy, it seems to me should be the goal of our national policy.

Gentlemen, thank you so very much for your very fine testimony. [Applause.]

Senator FOWLER. I now invite Mr. Eley Frazer, Dr. Joe Marshall, Mr. C.M. Stripling and Mr. Frank Strickland to join us.

Mr. Eley Frazer, president of F & W Forestry, if you would like to start.

Mr. FRAZER. Yes, sir.

STATEMENT OF ELEY C. FRAZER III, PRESIDENT, F & W FORESTRY SERVICES, INC., ALBANY, GA

Mr. FRAZER. Senator Fowler, Senator Pryor and other distinguished Members of Congress, my name is Eley Frazer. I am not

the president of F & W, I am chairman of the board—you kicked me down. [Laughter.]

But I am a forestry consultant. We also manage farmlands. Our consulting foresters are out every day advising timberland owners throughout the Southeast, principally in the State of Georgia, but we cover the total Southeast.

I am also here today representing the Forest Industries Committee on Timber Valuation and Taxation, a national organization of thousands of landowners, with supporters ranging from the very largest, fully integrated manufacturing companies, to the smallest, nonindustrial private landowner, who are all interested in fair taxation for timber.

Mr. Chairman, I have a prepared statement here, but I want to try to answer some of Senator Pryor's questions——

Senator FOWLER. Please.

Mr. FRAZER [continuing]. Before I start this prepared statement.

Senator FOWLER. We will just put your prepared statement in the record so we can continue this discussion.

Mr. FRAZER. OK, but I have a longer statement for the record, if you will allow me to put it in there.

Senator FOWLER. I will allow you to put the long one and the short one in if you will not read either one.

Mr. FRAZER. Your statement, Senator Pryor, about the timber that was produced—well, I believe it was Representative Rowland—how much timber was produced on an acre of land. An acre of land ranges widely. If you start in the sand hills of Berrien County it is doggone little, but by the time you get to the coast you are producing considerably more.

I think Representative Thomas' estimate of $50 an acre a year is a good estimate. Some of our croplands that we are planting will produce $100 worth of timber an acre, but they are exceptional sites, but the thing about that is you have to hold that timber from the time you plant it for 30 years if you are going to get that kind of money, at least 25 years if you are going to get that kind of money out of it, so the first 15 years you have nothing out except the trees standing there that can only be resold with the land, it has no marketable value, so any income you would get would be put off at least 15 years, so that $50 is really, you know, an image out there that you are going to get, but you are going to get that in 30 years, not in 10 years or even 15.

The other thing is in 1960 when we planted trees it cost us about $50 an acre to get the woodland site prepared and the trees planted. Today, 30 years later, if we sell those trees we get back our $50 investment, but what is it worth? Twelve dollars and a half maybe in actual money, so we have gone over all those years and gotten back $12.50 of the $50 we put in, and now today it costs us $200 to do that same thing. Are we going to get back $50 30 years from now instead of $200?

And on top of that, if we are not allowed to deduct our expenses, say $5 an acre a year in management costs until we cut timber, it is 15 years before we get that back. We are lucky if we get half of that back in purchasing power. That is what is wrong with this thing, and I would like to say also—I get excited about this thing——

Senator FOWLER. Get excited, go ahead.

Mr. FRAZER. We do not need—it is not incentive, it is lack of disincentive. Who puts anything out there, who makes the investment on a piece of property and it sits there for 15 years before they get one dime back? The timber grower, that is the only one.

Stocks and bonds, no. Anything else—you build a plant, in 2 or 3 years you are going to start getting income. This is not so with timber.

This is not preferential treatment, it is unfairness when you take away capital gains, and it is certainly even more unfair when you take away our benefit to expense our costs, because there is no depreciation involved, trees do not depreciate, land does not depreciate, we do not have anything else involved in it.

There is no depletion of it. They call it depletion, but it is actually return of money that we have to put in that piece of property. That is the only piece of money we get back, and I have just explained to you we generally do not get back but about 25 percent of that, so this is my problem and this is where I will try to answer your question.

I am out there every day dealing with a nonindustrial landowner, trying to get him to plant trees. Some of these people have planted trees since 1962, when I went into the business I am in, every year with their own money, what has the government done to them? They have come along with a big program that pays the farmer across the fence, rents his land for 10 years to plant trees. What is that? That is reducing competition for this fellow nonindustrial landowner.

I am not knocking that program, it is great, but you have done nothing for the forest landowner when it comes to growing trees, except to take what little fair taxation he had away.

I could go on I guess all day, but I am not. I just want to let you all ask me questions when and if you want to.

But that, gentlemen, is what has happened. You can couch it in any terms you want to, and I have worked on it from 1962, I mean for 30 years. The forestry industry return on forest land before taxation has been about a 4 percent return, that is before taxes. Uninflated it is about 4 percent.

When Representative Thomas was talking about 6½ percent it is not in the cards, gentlemen. I just sold a tract of my own that I had in my pension plan, and the fact that I did not have to pay taxes on it, held it for 15 years because I rolled it over into another plan, I only received a little less than 6 percent return on that thing over 15 years. If I had had to pay taxes on it, I would have received about one-quarter of that, I would have got lucky with a 1½ percent return, because the taxes and the regeneration of it would have taken about 60 percent of the timber that I would have sold off of it.

We have problems. There is no incentive out there to grow timber under our present tax situation, and we need to do something about it.

Thank you.

Senator FOWLER. Thank you, Brother Frazer. I think you have the hay down where us goats can get to it.

[The prepared statement of Mr. Frazer follows:]

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TESTIMONY OF

ELEY C. FRAZER, III

PRESIDENT OF F & W FORESTRY SERVICES, INC.
ALBANY, GEORGIA

ALSO REPRESENTING

FOREST INDUSTRIES COMMITTEE
ON TIMBER VALUATION AND TAXATION

BEFORE

SENATOR WYCHE FOWLER'S HEARING

ON

TAX ISSUES AFFECTING THE FOREST PRODUCTS INDUSTRY

MONDAY, MARCH 13, 1989

MACON, GEORGIA

Testimony

of

Eley C. Frazer, III

Thank you, Mr. Chairman.

Senator Fowler, Senator Pryor, and other distinguished Members of Congress, my name is Eley Frazer. I'm the founder and President of F & W Forestry Services, Inc., a forest management consulting firm located in Albany, Georgia. Our consulting foresters provide advice and management regarding sound forestry practices to hundreds of timber growers throughout the South, although most of our clients are right here in Georgia. We're on the front lines every day with landowners, and see first-hand the severe economic hardships inflicted on them from the "Tax Reform Act of 1986."

I am also here today representing the Forest Industries Committee on Timber Valuation and Taxation, a national organization of thousands of landowners, with supporters ranging from the very largest, fully integrated manufacturing companies, to the smallest, non-industrial private landowner, who are all interested in fair taxation for timber. In that regard, and with your permission, Mr. Chairman, I would like to request that a more detailed statement be allowed to be submitted for the record on behalf of the FICTVT and its members.

Mr. Chairman, as landowners of every size, we are all united in our view that certain aspects of the "Tax Reform Act of 1986" need to be corrected not only to restore fair taxation, but to also prevent an irrecoverable future loss to our Nation's timber supply.

The two major issues of greatest concern to timber growers are the unfair and restrictive passive loss rules, and the overwhelming need to restore a capital gains differential.

First, let me address the passive loss issue, originally meant to end abusive tax shelters. That was all well and good, but in the process, they hit timber growers right between the eyes. I think Congress' eyes must have been closed at the same time, because the way the rules are being written, most timber owners won't be able to currently deduct their necessary yearly forest management expenses, and that's wrong. Timber isn't a tax shelter in the first place, certainly not in the sense that Congress thought of when the law was first passed. For instance, there's no depreciation; the cost of planting is capitalized, not expensed; there is no non-recourse debt -- our money is literally in the ground, and the banks look to us personally to pay back any debt. In essence, timber growing has none of the characteristics normally associated with so-called tax shelters.

But we're being made to suffer, unfairly, by the misapplication of those rules. While we hope that the U.S. Treasury will issue final regulations recognizing the nature of growing trees, we support the initiative of Representative Lindsay Thomas, and the other Co-chairmen of the "Forestry 2000 Task Force," who recently introduced H.R. 1086, "The Farmers and Woodland Owners Tax Simplification Bill of 1989," which clarifies the passive loss rules as they should apply to timber. Mr. Chairman, I would also urge that you consider sponsoring similar legislation in the U.S. Senate. Your help on this issue would be very important to us.

The second issue of critical importance to timber growers is the need to reinstate a capital gains differential. While the lower overall rates of the 1986 tax bill may have been favorable to some, most landowners have found that the loss of capital gains was a devastating blow, just now being felt. In fact, the loss of capital gains was one of the most unfair parts of the 1986 bill. Thousands of timber growers planted trees decades ago with the confidence and assurance that capital gains would be there when time came to harvest. Now capital gains is gone, and landowners have been left out in the cold. The rules were changed in the middle of the game with no opportunity for timber growers to react the way others could. Our trees are still in the ground.

Mr. Chairman, a few observations on timber growing might be in order:

1. Timber takes a long time to grow -- tying up critical investment. What other industry takes 20 to 75 years to get a return on its initial investment?

2. Timber growing economics are tough, requiring three things:

    A. Heavy front end investment

    B. Substantial carrying costs

    C. Willingness to be locked in during growth

3. There are very high natural hazards, with high risk from weather, disease, insects, and fire -- in fact, you cannot get commercial insurance for these risks.

4. In spite of the risks, the rate of return on timber is low, maybe 4% before taxes, uninflated.

5. Perhaps contrary to what you may be reading in the Washington papers, capital gains isn't just for the rich. In fact, 1981 IRS figures show that of the individual tax return reporting timber sales, over 80% had adjusted gross incomes of less that $50,000. There are thousands of landowners in Georgia who don't consider themselves

rich, but relied steadily on capital gains.

Mr. Chairman, the capital gains provision of the Tax Code has proven to be an effective mechanism for increased production and improved forest management. When it was enacted in 1944, it reversed a declining timber economy. Public and private forecasts of future demand and supply indicate potential significant shortfalls in supply over the next few years and beyond if timber growing is not increased at faster rates. The restoration of the capital gains structure and its continued application to timber and to both individuals and corporation is essential if timber growers are to meet raw material demands for the thousands of consumer products dependent upon wood and fiber.

The need for a fair economic environment for timber growing is greater now than ever.

Thank you for this opportunity, Mr. Chairman.

Senator FOWLER. Joe Marshall, president of the Southern Plantations Group, Inc. Thank you for joining us.

STATEMENT OF JOSEPH H. MARSHALL, PRESIDENT, SOUTHERN PLANTATIONS GROUP, INC., ALBANY, GA

Dr. MARSHALL. Thank you, Senator Fowler, for inviting me.

Senator Pryor, members of the Georgia Congressional Delegation:

I will skip through my written remarks here and make a few verbal comments, leaving the other for the record, and leaving more time for discussion.

Senator FOWLER. Thank you very much.

Dr. MARSHALL. My name is Joseph H. Marshall, I am president of Southern Plantations Group of Albany, Georgia. My activities, and the activities of my company, are concerned with the management and operation of agricultural and timberland, principally in Georgia and the Southeastern United States. Our clients are owners of and lenders to agricultural and timberland. As managers and consultants, we are vitally interested in the issues affecting the agricultural and forest industries.

The Tax Reform Act of 1986, while lowering overall tax rates, has been increasingly perceived as detrimental to the timber growing industry and forestry investment in general, as has been stated so eloquently today. Some of the provisions that have been discussed earlier, that are a detriment, are the increasing of the depreciation, required depreciation schedules, the deductions for expenses, and certainly most of all the capital gains tax.

Under law prior to the Tax Reform Act of 1986 a 60 percent exclusion on capital gains income was allowed. This in effect meant that income from the sale of timber was taxed at only 40 percent of the marginal Federal tax bracket. This was probably one of the most powerful incentives to invest in the growing of timber.

The elimination of this tax differential under the new legislation is having a serious effect on our Nation's long-term timber supply due to the hesitancy of investors to commit capital to the long-term 30-year term required to grow timber.

In the real world individuals and organizations will compare forestry investments with alternative investments before making an investment. The current situation makes it extremely difficult for people like us to recommend forestry investments and new plantings.

In making their comparisons they are likely to use certain traditional analytical criteria. For purposes of comparison I have used a computer program to illustrate the effects of, for example, a 50 percent capital gains exclusion on a typical 30-year woodland investment in southern Georgia. I have used typical data which are a part of the record, and will not discuss them here in the interest of time, but the results of this computer model indicate that with just these differentials the attractiveness in terms of net present worth is increased by 89 percent. The same for the annual equivalent value, for the discounted cost or the discounted benefit/cost ratio, a 17 percent increase. For the soil expectation value, again an 89 percent increase with just that incentive alone.

The conclusion to be drawn from this very simplified exercise is that the lack of a capital gains provision in the Tax Reform Act of 1986 lowers the potential value of all forestry investments. Taken along with the elimination of the other incentives to invest in timber growing, the lack of a capital gains tax differential is likely to contribute to a further decline in reforestation. This comes at a time when harvested softwood timber volume is exceeding softwood growth in spite of such direct payment incentives as the CRP Program.

Reinstatement of the capital gains tax differential on a permanent basis will provide a self-perpetuating insurance of an adequate timber supply for future generations, while reducing the need for expenditure or direct payment incentives.

Some farmers and other small lot owners may use less sophisticated analytical techniques, but are and will intuitively be turned off by both the expense deduction and material participation requirements.

Mr. Chairman, it is my hope that the Congress will reconsider the capital gains and other restrictions imposed by the Tax Reform Act of 1986 and revert to regulations equal or similar to those in effect before. Such action would provide the needed stimulus to help ensure adequate forest products for future generations.

Thank you.

Senator FOWLER. Thank you, Dr. Marshall. Thank you very much. [Applause.]

[The prepared statement of Dr. Marshall and his Criteria Used for Computer Simulation Model follow:]

Testimony of

Joseph H. Marshall

Southern Plantations Group, Inc.

Albany, Georgia

Before the

Subcommittee on Conservation and Forestry

Committee on Agriculture, Nutrition and Forestry

United States Senate

Field Hearing

Macon, Georgia

March 13, 1989

Testimony

My name is Joseph H. Marshall. I am President of Southern Plantations Group, Inc., Albany, Georgia. My activities, and the activities of my company, are concerned with the management and operation of agricultural and timber land, principally in the Southeastern United States. Our clients are owners of and lenders to agricultural and timber land. As managers and consultants, we are vitally interested in the issues affecting the agricultural and forest industries.

The Tax Reform Act of 1986, while lowering overall tax rates, has been increasingly perceived as detrimental to the timber growing industry and forestry investment in general. Some of the major aspects of the 1986 act affecting the timber industry include:

Testimony by Joseph H. Marshall, President, Southern Plantations Group, Inc., P. O. Box 1683, Albany, GA 31702, (912) 439-0012... before the U. S. Senate Subcommittee on Conservation and Forestry Field Hearing in Macon, Georgia, March 13, 1989.

Depreciation - Seven-year and 20-year recovery classes were added to the Accelerated Cost Recovery System pertaining to personal property. These were in addition to the 3-, 5-, 10- and 15-year classes previously available. Although a faster method of depreciation was prescribed, the re-classification of light trucks and certain logging equipment from the 3-year and 5-year classes to the 5-year and 7-year classes respectively, will result in less favorable depreciation schedules when interest rates are high. Also, total depreciation deductions cannot exceed the taxable income derived from the "active" aspect of ones involvement with the enterprise. Compliance with certain material participation criteria are required in order for income to be classified as active.

Deduction For Expenses - Rules regarding deductible expenses were made more restrictive, particularly for those individuals that might have difficulty in satisfying material participation requirements. In certain circumstances restrictions on deducting expenses in the year incurred could act as a deterrent to performing management activities which otherwise might have been performed.

Capital Gains Tax - Under law prior to the Tax Reform Act of 1986 a 60% exclusion on capital gains income was allowed. This in effect meant that income from the sale of timber was taxed at only 40% of the marginal federal tax bracket. This was perhaps one of the most powerful incentives to invest in the growing of timber. The elimination of the capital gains tax differential under the new legislation could have serious effects on

> our nation's long term timber supply due to a hesitancy of investors to commit capital to the business of growing timber which has unique associated risks.

In the real world, individuals and organizations will compare forestry investments with alternative investments before making an investment. In making their comparisons, they are likely to use certain traditional analytical criteria.

For purposes of comparison, I have used a computer program to illustrate the effects of a fifty percent capital gains exclusion on a typical 30-year woodland investment in South Georgia. I have used typical data and assumptions, copies of which are available but not discussed here in the interest of time. Results of the computer model are shown in either dollars per acre or percentages, and are as follows:

Table 1 - Comparison of After Tax Forestry Investment Analysis Criteria With and Without a Capital Gains Differential

	NCGD	50% CGD	% Increase
Net Present Worth	$96.39	$182.53	89%
Internal Rate of Return	11.0%	11.7%	6%
Composite Rate of Return	10.2%	10.8%	6%
Annual Equivalent Value	$10.22	$19.36	89%
Discounted Benefit/ Cost Ratio	1.2	1.4	17%
Soil Expectation Value	$101.69	$192.56	89%

NCGD - No capital gains differential

50% CGD - Capital gains taxed at 50% of the marginal federal tax bracket.

The conclusion to be drawn from this simplified exercise is that the lack of a capital gains provision in the Tax Reform Act of 1986 lowers the potential value of all forestry investments. Taken along with the elimination of other incentives to invest in timber growing, the lack of a capital gains tax differential is likely to

contribute to a further decline in reforestation. This comes at a time when harvested softwood timber volume is exceeding softwood growth in spite of such direct payment incentives as the CRP Program.

Reinstatement of the capital gains tax differential on a permanent basis will provide self-perpetuating insurance of a adequate timber supply for future generations, while reducing the need for expenditure or direct payment incentives.

Some farmers and other small lot owners may use less sophisticated analytical techniques but are and will intuitively be turned off both by the expense deduction and material participation requirements.

Mr. Chairman, it is my hope that the Congress and the White House will reconsider the capital gains and other restrictions imposed by the Tax Reform Act of 1986, and revert to regulations equal or similar to these in effect before. Such action would provide the needed stimulus to help ensure adequate forest products for future generations.

Thank you.

(Criteria Used for Computer Simulation Model follows:)

Criteria Used for Computer Simulation Model

The approach taken was to simulate a situation where a prospective investor is considering the purchase of recently cut-over woodland in south Georgia, and re-establishing it to a loblolly pine plantation to be grown on a 30-year sawtimber rotation. The land would then be sold after harvesting the final crop. This type of investment would presumably be compared to alternative investments using certain criteria such as Internal Rate of Return or Present Net Worth. The purpose of this exercise is to illustrate the effect that a capital gains tax differential would have on such investment analysis criteria.

Analysing forestry investments is a fairly complex process and the results obtained can vary considerably depending on initial assumptions. The focus here was on the percentage change in the value of the various criteria (IRR, NPW, etc.), rather than on the merits of various market and management scenarios. The investment is analysed on an after tax basis with and without a capital gains tax differential. The initial assumptions selected are considered

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Criteria used for Computer Simulation Model for Testimony by Joseph H. Marshall, Southern Plantations Group, Inc., Albany, GA 31702, before the U. S. Senate Subcommittee on Conservation and Forestry Field Hearing in Macon, Georgia, March 13, 1989.

to be farily typical for south Georgia in 1989, but are used for illustrative purposes only. The number of potential scenarios are technically unlimited.

The basic assumptions used were as follows:

Cost of Land:	$200 per acre
Cost of Site Preparation and Planting:	$150 per acre
Annual Taxes and Administration:	$4 per acre
Site Index:	60 (Base age = 25 yrs.)
Initial Stocking:	800 seedlings per acre
Thinnings:	One thinning at age 15 years to a residual basal area of 80 sq. ft./acre
Clearcut:	Clearcut harvest at age 30 years.
Simulation Model:	YIELD-plus using site-prepared loblolly module.
Stumpage Prices:	1988 average prices for south Georgia as published in Timber March - South.

Pulpwood - $24.58/cord
Chip-N-Saw - $50.00/cord
Sawtimber - $183.00/MBF Scribner
Ply Logs - $193.00/MBF Scribner

Rate of Inflation:	4% per year
Rate of Stumpage Price Increase:	5% per year (i.e. 1% above inflation)
After Tax Discount Rate:	10%
Sale of Land:	Land is sold after the clearcut harvest. Land price appreciates at the rate of inflation.

Capital Gains Tax Scenarios:

1. Current law where capital gains are taxed at 100% of the marginal federal tax bracket.

2. Preferrential treatment of capital gains income where a 50% exclusion is allowed.

The YIELD-PLUS simulation model calculates value for the following criteria. Definitions are extracted from the software documentation.

Present Net Worth: Revenues discounted to the present year less costs discounted to the present year.

Internal Rate of Return: The interest rate at which discounted revenues equal discounted costs. It assumes that all intermediate revenues (i.e., thinning revenue, tax savings, etc.) are reinvested into the project.

Composite Rate of Return: The rate of return assuming that all intermediate revenues are reinvested at the specified discount rate. Some view this as a more realistic measure of performance than IRR since not all investors have the option to reinvest intermediate cash flows back into a similar project as is assumed by the IRR.

Annual Equivalent Value: Net Present Value expressed as an annuity over the planning horizon, computed at the discount rate. This is a useful measure for comparing investments of unequal length. For example, AEV might be useful to compare forestry investments (periodic) to agriculture (annual).

Discounted Benefit/Cost Ratio: Revenues discounted to present year divided by costs discounted to present year. The project is profitable if the value is greater than one. This value is commonly used for ranking public projects.

Soil Expectation Value: Present Net Value of perpetual repetitions of the investment described in the planning horizon window. This value is useful for comparing investments of unequal length and for determining bare land value.

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NCGD - No capital gains differential

50% CGD - Capital gains taxed at 50% of the marginal federal tax bracket.

Senator FOWLER. The American Tree Farmer of the Year, Mr. C.M. Stripling. Welcome, my friend. We are glad to help Mr. Frazer put the rubber on the road here.

STATEMENT OF C.M. STRIPLING, AMERICAN TREE FARM SYSTEM, CAMILLA, GA

Mr. STRIPLING. Senator Fowler, Representative Ray, Representative Thomas, Representative Rowland, and Representative Lewis. I appreciate the opportunity to testify before this committee on the capital gains issue. When the 1986 Tax Reform Bill—a better name would be the 1986 Tax Deform Bill or reforestation bill. [Laughter.]

Mr. STRIPLING [continuing]. Was about a week before coming to a vote in the House, I called Bob Redding—aide to Representative Hatcher at that time, and now your aide—and told him that this bill would cost me several thousand dollars a year and a lot more of the Congressman's constituents would suffer the same fate. Bob more or less agreed, but said that it was going to pass anyway, and I agreed, but I just wanted to go on record with my opposition to it.

It passed, of course, and as we all know has been a nightmare. More and more taxpayers are having to have their income tax forms prepared by professionals who are charging more to do it because of the complexity of this simplified tax reform law.

The IRS is complicating this mess further by the "passive loss" rules. I understand that the intent is to prevent people from taking deductions for a summer place where they grow a few trees as a hobby, but requiring that each landowner show 100 or more hours of work on their tree farm each year in order to be able to deduct expenses is ridiculous. I spend plenty of time on my tree farm because I live there, but my children live far away from the farm. I plan for them to carry on the tree farm work after I am gone, but they will have to use help to get the work done and make decisions from a distance. There are a lot of people like this who live at a distance from their land. And a lot of people whose land is not in a phase that requires 100 hours or more of work in a year.

On Friday I called Mr. DeCosta, the head of the tree farm, American Tree Farm System, and talked to him about the passive loss rules. He tells me that the IRS is not even considering where a person walks through his trees as work. I think that anybody that farms trees or farms peanuts or anything else, the most important thing he can do is to walk through that land.

Too many farmers through the last few years have rode up and down the road in a pickup and did not get in the field. This could probably be some of our problem. This is one of the most important things that you can do as a tree farmer is walk through it. When you ride up and down in a pickup you just get a passing glance.

We are not running hamburger stands where we go to work every day, we are growing trees over many years. The tax folks do not understand this at all.

The research firm of Arthur D. Little reports that it will take more than 5 billion hours to prepare the 1988 tax forms, where it took only 4.3 billion hours to prepare the 1983 tax forms. The IRS has maintained that it took only 631 million hours, but they did not count in the recordkeeping that one has to do to be able to pre-

pare this tax form or present it to one who prepares income tax forms for the public. A monstrosity has been created.

In April of 1987 you were in Baker County for a town hall meeting. At that time I mentioned the capital gains tax dilemma to you and gave to you a printout that I had a CPA do for me. The printout showed what my income tax for 1986 would be, and also projected the 1987 and 1988 tax that I would owe under that new law using the same income that I showed for 1986.

In doing the projection, he ran my 1986 income and deductions through his computer using the 1987 and 1988 tax changes. To my dismay, my 1987 taxes would be up 57 percent over 1986, and my 1988 taxes up 71 percent over 1986 using the same income and deductions that I reported on my income tax return for 1986. The return took four pages for 1986 and nine pages for 1987 and 1988—an increase of over 100 percent in paperwork for the new law. The main reasons for the increase are loss of capital gains. I understand that timber growing has been linked with other abusive tax shelters that Congress was trying to do away with. This is naive thinking. In south Georgia, it takes 13 years after a seedling is set before you can get any kind of return, and then only if you are lucky and thinnings don't cost more than they bring to harvest them. If you are growing sawtimber, you are looking at 30 to 45 years with thinnings now and then that might cover expense incurred along the way. If growing pulpwood, you would harvest in about 20 years with a lot less earnings for your labor.

It is my belief that Congress has to take another look at the timber situation in regards to capital gains. Perhaps there could be a waiting period of 5 to 7 years after the purchase of timberland before it would be eligible for capital gains. If raising timber, it would be at least 13 to 15 years before any kind of harvest. With so long a waiting period, it should automatically qualify for capital gains treatment or be totally exempt from any kind of tax.

After I discovered from talking with the tax expert I went ahead in 1987 and sold all the timber that I thought I might sell in the next few years just to take advantage of the capital gains tax as it was then. I have not sold any since then except some that I had to sell because of fire or insect pressure.

I had some stock. I sold it in 1987 because of the capital gains. I know we are not looking at only the problems with the trees, we are looking at problems of stock. People over the years have very little basis in it, and it is a big capital gain there and you have to pay on it. Somewhere along the line I made up my mind I am not going to sell anything else until we get some kind of relief from it, unless it is an exception.

With no tax incentives, the only way that trees will get planted will be through government programs such as the Conservation Reserve Program. Do not get me wrong, I am an ardent supporter of CRP, but only so far as it pertains to taking highly erodible or marginal land out of production and planting a better crop—trees. The incentive for planting trees needs to be in producing the product for its own profitability, not for government payments.

When we lose forest land we lose a major natural resource that provides an essential raw material for wood and paper products. But forests serve us in many other ways, too. Tree farms like mine

provide important habitat for game and other wildlife. Hunters and campers know all about the value of healthy, growing forests for a variety of recreational uses. Without forests, our world would be a grayer place for all of us.

In conclusion, let us take a look at how other industrialized nations tax capital gains. The maximum long-term capital gains tax rate in the United States is 33 percent, the United Kingdom 30 percent, Sweden 18 percent, Canada 17.51 percent, France 16 percent, West Germany—exempt, Belgium—exempt, Italy—exempt, Japan—exempt, Netherlands—exempt, Hong Kong—exempt, Singapore—exempt, South Korea—exempt, Taiwan—exempt, Malaysia—exempt. Some of the fastest growing nations do not tax capital gains at all. This should tell us something.

I would like to add this too. If in 1975 you had invested $50,000 in timber and in 1988 you sold it for $100,000, if you index it for inflation you would not have made a dime. If you go with the 33 percent capital gains tax on it that we have now plus the 6 percent Georgia tax, you would have $20,000 worth of tax to come off of the $50,000, which would really and actually be a $20,000 loss from your original amount of money expended.

What you are looking at is a big problem, and I predict that the CRP land that is being put in now and if they do not have some incentive to keep it after it is in there for 10 years. Just as soon as it is merchantable pulpwood they will cut it down. I know that is what I anticipate doing if we do not get some relief.

Thank you.

Senator FOWLER. Thank you, Mr. Stripling. [Applause.]

Last, but not least, we have Mr. Frank Strickland, a tree farmer from Lakeland, Georgia.

Frank, welcome.

STATEMENT OF B. FRANK STRICKLAND, FARMER, ROUTE 1, LANIER COUNTY, LAKELAND, GA

Mr. STRICKLAND. Senator Fowler and members of the panel, we are delighted to have you all in Macon in our facilities here today in the Farm Bureau.

I am going to make—I have some material prepared that I am going to present to you—I am just going to make a few statements. I am here this morning representing the small farmer that has small tracts of timber in Georgia. Most of the timber in this State is owned by private farmers.

My family has been in farming in Lanier County, Georgia for over 100 years. We produce tobacco, cotton, corn, soybeans, peanuts, and timber. Our money crop is tobacco, but we use the timber as an income stabilizer. We try to maintain about 1,000 acres in timber, but we are finding it very difficult to cut timber, pay taxes, reforest the land and have a net income left over.

Let me say to you all this morning in my county, and I would say today we live in a small county in south Georgia, that we have probably got 3 to 4,000 acres of land in our county that timber has been cut off that is not going to be reforested.

Now, what has happened to the small timber owner in this State? We have had a depression up to this past year in agricul-

ture, a lot of his timber has had to be sold to pay the Federal land bank, FmHA, local banks, what have you for the farmer.

Now, the timber on my farm that me and my family, we have tried to keep over through the years has not been cut in 42 years, and I want you to tell me, as a small farmer, this morning after all of these years that me and my family has tried restore this timber and keep it, maybe for something that me and my wife could retire on, and now we come to the point that we want to get it cut, reforest, and we are having to pay a 34 percent tax on it.

If you sell $100,000 worth of timber, that is $34,000 in taxes that you are paying, plus another $15,000 to put that back in reforestation. You are talking about $50,000 there off 100 acres of good timber that you are going to have to pay in taxes.

Now let me remind you this morning I do not have to tell you gentlemen what has happened to ad valorem taxes in our rural counties in this State in the last few years. They are absolutely getting to where we cannot hardly afford to pay them. The taxes in my county, a small county in south Georgia, the ad valorem tax went up $100,000 in my county since 1988, so there is no way that the small timber owner is going to survive if this capital gain is not restored on timber.

You are going to see acres after acres in the Southeast where the small landowner is going to cut this timber, that is going to grow up in oak trees, persimmon bushes, grape vines, gall berries and palmettos, and what are you going to have. And probably, Senator Pryor, the same thing is happening in your State.

Senator FOWLER. The fire ants, do not leave them out.

Mr. STRICKLAND. Well, fire ants do not hurt timber. [Laughter.]

The armadillos are taking care of them now. [Laughter.]

But I do not know what can be done, but I do say this to you. We appreciate the fact that you came here today, but I am here this morning representing the small timber owners in this State. I serve on the Farm Bureau board here and throughout Georgia, and I am not going to take up a lot of your time. I have a prepared statement I would like for you to look at, but absolutely, gentlemen, something has to be done.

Timber is a big industry in the Southeast, it brings in a lot of income. Timber in south Georgia has saved some of our farmers in the last 3 or 4 years, and you are aware of that Senator Fowler, and you too, Representative Lewis. It has happened to the small landowner in this State and throughout the Southeast.

Let me say on behalf of our organization we support you. Any time that we can be any help to you, we are just as close to you as the telephone, and thank you very much.

Senator FOWLER. Thank you very much. [Applause.]

[The prepared statement of Mr. Strickland follows:]

STATEMENT BY B. FRANK STRICKLAND
FARMER, LANIER COUNTY, GA
BEFORE THE
SUBCOMMITTEE ON CONSERVATION & FORESTRY
OF THE SENATE AGRICULTURE COMMITTEE
MARCH 13, 1989

My family has been farming in Lanier County, Georgia for over 100 years. We produce tobacco, cotton, corn, soybeans, peanuts, and timber. Our money crop is tobacco, but we use the timber as an income stabilizer. We try to maintain about 1,000 acres in timber, but we are finding it very difficult to cut timber, pay taxes, reforest the land and have a net income left over. Taxes, from all three levels--local, state and federal, are making investments in timber very unappealing. Prior to the Tax Reform Act of 1986, forestry was a good way to invest in the future, and it also gave a farmer an incentive to plant trees. For nearly forty years, the Internal Revenue Service Code provided a tax differential for long-term investments such as timber. We try to grow saw timber which has rotation of nearly twenty-five years. This is what I call long term commitment. The federal government should continue their commitment and restore capital gains treatment for timber.

Trees are a natural way to conserve the land and preserve the environment. Forests retain and nurture the soil and act as a purifying filter for watershed areas. I think conserving our lands is something we should do and it is our responsibility. Every landowner should protect and conserve his property, but with the agricultural economy of the past decade, that is easier said than done. A lot of farmers that I know had to cut timber to get through this depression era on the farm. When the trees were harvested, the income had to go

to pay debts. Now the economy is recovering, and some farmers are beginning to have funds to invest in their operations. When they put the numbers on paper, farmers are finding investments with less risk and higher returns than timber. The loss of the capital gains exclusion is a major reason for this lack of appeal for investments in timber.

We need to plan for the future. As the motto of the Boy Scouts says, we must be "Be Prepared." We cannot continue to harvest more acres of timber than are planted. If we do not stop this trend, our enemy in the future will be ourselves. Wood products take time to produce -- the minimum is about 15 years for pulpwood. If a shortage of wood products occurs at some time in the future, the problem will take two decades to resolve. We must take steps to assure the generation to come that there will be plenty of timber available. If we wait until the shortage arises, it will be too late.

I humbly and very earnestly request that you restore the capital gains tax treatment of timber. It is needed as an investment tool for farmers and as an incentive for protecting the environment.

Senator FOWLER. Representative Lewis.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Let me just say to Mr. Frazer and Mr. Strickland and all members of the panel that I really appreciate your moving and forceful statements. I grew up on a 100-acre farm and, Mr. Strickland, we did walk through those trees from time to time, we raised some pulpwood, so I think I understand that you are talking about today, but let me just ask one question to any member of the panel.

Could you please elaborate on the effects of the passive loss stipulation of the 1986 tax law on timberland management for the small and large size timber farmer?

Mr. FRAZER. It will keep the timber owner from being able to write off his expenses until he has income from timber sales. If you plant trees today—I am not talking about the planting costs, I am talking about the carrying costs, ad valorem taxes, the forest management costs and that—if you plant today and you cannot sell, say for 15 years, you have to capitalize that in effect for 15 years before you get it back when you make your first sale.

This is what I am saying, you do not get your money back, you do not get your purchasing power back, you get maybe half of it back in 15 years with inflation being what it is and what it is going to be, what it has proven to be over the past 30 years. It is just disastrous.

Mr. LEWIS. Thank you.

Senator FOWLER. Mr. Ray.

Mr. RAY. I think that the presentations that all of you made have just been really excellent, and Mr. Mixon had mentioned in his testimony that on 23.7 million acres 100,000 timberland owners are operating that land. I think for the record, if we could put into the record the percentage of those 100,000 timberland owners who are small business-people or family owners and not a big business. Would anyone have that information?

Mr. FRAZER. Let me make one statement here I think you ought to carry back to Washington. In 1981, the IRS figures showed that, of individual tax returns reporting timber sales, over 80 percent of them had adjusted gross income of less than $50,000, so when these people are talking about rich folks owning it and getting the timber money they are wrong, absolutely wrong—80 percent of the tax reporters had less than $50,000 in adjusted gross income, and when you get up to $100,000 it is something like 91 percent.

Mr. RAY. Would that 80 percent be family owners or small farmers?

Mr. FRAZER. That would be people like me, who have invested in timber and hoped that that would be my retirement, and I am still paying bank payments or mortgage payments, and the way it has wound up I would have been one whole lot better off to put that money somewhere else than in trees, because I will not even get my original investment back in all probability if we continue what we are doing now.

Mr. RAY. Thank you, sir.

Thank you, Mr. Chairman.

Senator FOWLER. Dr. Marshall or Eley, is there any interest at all amongst your clients and the farmers in planting hardwoods?

Dr. MARSHALL. Not really.

Senator FOWLER. In addition to what we have been talking about, what would it take to——

Mr. FRAZER. Senator, you do not have to plant hardwoods. You can shear it down, clear-cut it and it will come back on its own, but it costs money to do that.

I think the same thing, that hardwood prices having been rising, and I think over a matter of time—of course, I have been thinking that since 1948 when I was hauling pulpwood, but I think hardwood prices have risen over time, and in fact in west Alabama we are getting more for hardwood pulp than we do pine pulp, but given it takes longer to grow it, but given the same opportunity we will grow hardwood, but we have to have some reasonable taxation to do it before we can make any money.

Mr. STRICKLAND. Could I ask him a question?

Senator FOWLER. Sure.

Mr. STRICKLAND. How long do you think it would take to grow hardwood where you—how many years would it take to grow it to where you could cut it?

Mr. FRAZER. Well, you can start cutting pulpwood in probably 25 years, it would take at least 50 years to grow hardwood.

Mr. STRICKLAND. I would say 50 to 75 years to cut hardwood.

Mr. FRAZER. A minimum of 50.

Mr. STRIPLING. It does not matter what it is, you have still got to have a capital gains tax, with inflation it does not matter what you plant.

Senator FOWLER. Well, as you know, and I know from the panel that you are preaching to the choir here. [Laughter.]

What we are trying to do and where this is going to be so helpful is to make the record. As I say, we were warned 2 years ago, and you and Frank—well everybody at this table were a real early warning system for those of us from Georgia who had responsibilities in Washington at the time, but we did lose that battle, and now 2 years later we have the tax returns and the extraordinary loss in our cuttings and lack of plantings that all of you predicted at the time. It is not pleasant when we get it wrong, but we got it wrong.

Mr. FRAZER. Senator——

Senator FOWLER. Let me just finish this thought, Eley.

But what we have to do from here is to figure out, as Senator Pryor said, how we make the case that 60 percent of the people we are talking about in this country are private timber farmers making under $15,000 or $20,000 a year. We have statistics to show that, and now we have the tax returns and the statistics to show that even with that group in that 60 percent, who are the smallest private timber, nonindustrial, how much they have earned, and as a result of it there is no incentive whatsoever in all of this talk about the need for tree cover, the environmental as well as industrial uses for our forests. We just do not have it, so we are hoping that since our new President has expressed this interest in looking at capital gains we are going to have a record for him to look at that will make the case that the policy is backward.

Mr. FRAZER. Senator, one other thing.

Senator FOWLER. Yes, sir.

Mr. FRAZER. It is not good fiscal policy, it is costing the government money, not making money. It is actually going to cost our Congress, our Treasury money to do what they have done over retaining capital gains.

Senator FOWLER. Right.

Senator PRYOR. May I make a comment?

Senator FOWLER. Please.

Senator PRYOR. Back in the fall campaign President Bush—I had to step out of the room, this may have been mentioned—says "Read my lips."

Mr. STRICKLAND. We heard that.

Senator PRYOR. "Read my lips, no new taxes." Everybody cheered and that is wonderful, so now he has a budget director named Mr. Darman, we have all known Mr. Darman a long time. Mr. Darman has said, "Well, we may look at a few of these changes in this area and that area, but let me tell you something, Congress," that is what he says, "any time that you bring a proposal this administration is going to, "cut revenue," according to the budget-crunchers that do all these—number crunchers we call them—he says "any time you cut revenues you are going to have to find a way to find some more revenues that are not called revenues." He says, "you can call them user fees or revenue enhancement or something, but we cannot have any taxes."

So we have a dilemma here, it is a practical political dilemma that we are faced with. You have a problem that needs to be corrected, and your problem is our problem, and it is in Arkansas, it is in Georgia and throughout the South and the Southeast.

If we take these proposals to them, it is a revenue cutter as they say, we have got to find an offset. I do not know where that offset is going to be, but I would like to suggest, Senator Fowler and my colleagues, that we summarize a position that you have just stated that the capital treatment as it now stands starting in 1986, that you summarize in a short white paper, three or four pages, that this is ultimately going to create new revenues if we agree to make this change.

Now, we have to convince them of that. It is hard to convince them of that. I will do my best, but once we open this thing up, we say "let us change this capital gains for timber," then we are going to have some others come in and say "wait a minute, we see this—we see this train leaving the station on a little tax amendment, we are going to get on there," so we do not want to make a Christmas tree out of it. It will have to be very carefully done as our colleagues in the House and Senator Fowler know.

I just hope that you can summarize what we are talking about here and make a position that we can take to Mr. Darman and others in the OMB.

Mr. STRICKLAND. Senator, let me ask you a question. You take all of this land where the timber is being cut, not being reforested, you know, from a tax situation on down the road look at what they are going to lose.

But I think if you could restore capital gains to where we had it, then I would say over two-thirds of this land would go back into reforestation.

Senator FOWLER. Well, Senator Pryor was talking about the revenue side of it and our problem with budgets. Whenever you are going to give any kind of tax credit or deduction they are trying to make us find an offsetting cut, but I think the real chance and the reason we have to pursue it, I mean we are putting the heat on all these other nations, you know, to quit cutting their forests as the other panel discussed, and here we are decimating ours and doing nothing whatsoever to encourage reforestation. That is going to give us soil conservation problems, environmental problems, erosion, all of which, Frank, you described very well, so what we have to do is figure out how to put the two halves together to make the environmental case along with the revenue case if we are going to have any reforestation, not just have everybody go and cut what they have down and get out of the business. There has simply got to be some changes. You make that case very well. How we translate that with the help of this administration is not an easy hurdle, but that is why we are here.

Mr. STRIPLING. I know we do not have any short-term gains in timber, but you have short-term gains in stocks and on the commodity trading and all that. Why not go up on that, go up on your tax on your short-term gain and then give the long-term gain, to the man—that is the man—the long-term gain man is the man that is going to keep this country going. The short-term man is going to turn it over all the time.

And I will just go a little bit further. The short-term gain man is the one that has created all this mess with the stock market. He is there one day, and he turns over and makes a profit and he is gone. If he knew that in 6 months or a year he could deduct, he could pay a tax of 15 percent he would not be that quick to let it go, and all this is going to tie in together when you get ready to make your presentation to Mr. Darman.

I think he is the duck man, is he not? He is the one that talks like a——

Senator PRYOR. Yes, that is right.

Mr. STRICKLAND. He is a duck, anyway.

Senator PRYOR. I was in that hearing that day, the day of the duck test.

Mr. STRIPLING. But I think this is one approach that could be taken, tax short-term gains longer, long-term gains shorter.

Senator FOWLER. Gentlemen, thank you so much. We have one more panel. [Applause.]

Mr. Robert Chambers, Mr. Walter Jarck, and Mr. Peter Kirby.

Gentlemen, you are last, but you are certainly not least, but as in any hearing when we get down toward the end we have covered a lot of the ground, so I would appreciate very much your submitting your written testimony for the record, and then reacting in any way you see fit to anything that has gone before, as well as your own suggestions.

We will begin with Mr. Robert Chambers, the vice president and manager of First Wachovia Investment Management. Welcome.

STATEMENT OF ROBERT G. CHAMBERS, VICE PRESIDENT AND MANAGER OF TIMBERLAND, FIRST WACHOVIA INVESTMENT MANAGEMENT, ATLANTA, GA

Mr. CHAMBERS. Thank you, Senator Fowler.

This is a double pleasure for me appearing before this distinguished panel of Senator Fowler and Congressmen from my adopted State of Georgia, a great and progressive State, and appearing before Senator Pryor from that great State of Arkansas, my birth State. It is a double pleasure for me.

Senator PRYOR. What town?

Mr. CHAMBERS. Born and reared in Pine Bluff, and what little education I was able to assimilate was at Arkansas A&M College in Monticello.

Senator PRYOR. Are you still registered to vote in Arkansas? [Laughter.]

Mr. CHAMBERS. There is a gentleman in one of the little rural counties who casts my vote, Senator. [Laughter.]

I have family that works at the mill in the home town that you are from, so we are well acquainted with the fair State of Arkansas.

I would like to digress briefly from the prepared remarks I have and make two observations.

One is in light of the question that was just asked. I have a letter from a client we represent from Milwaukee, and this family is investing in timberland as a fund for their grandchildren's future, and he makes the comment that the longer one holds an investment the greater the reduction in capital gains ought to be, and I think this family has great foresight in putting this investment in America's future for their grandkids, but they are very much concerned with the viability of that investment when their grandkids mature.

The other thing I would like to point out is this is a very unique asset, and because of its uniqueness it becomes very complex. As an example, many of the problems we have heard today which we have concurred with in its entirety do not apply to the large, wealthy investors such as corporations or institutions.

We at First Wachovia, which is the trust department of a bank holding company, have additional responsibilities as landowners rather than the ones of Mr. Strickland and Mr. Stripling. We have a fiduciary responsibility of ownership. That means that although we cannot benefit from ownership of assets such as this, we have the legal requirement to prudently manage these assets. And, gentlemen, a prudent man does what other men do.

There is a gentleman in this audience that is fond of saying that the most prudent lemming when they go over the cliff is the one right in the middle, and that is the fiduciary concept of management and it is that you legally manage assets as other prudent men manage assets. When Mr. Stripling says that he may not sell other assets until something is done, that is a prudent man making a decision.

What we would like to point out is there are really basically three distinct impacts of the Tax Reform Act of 1986 on timberland as an investment. That is one, simplification and fairness, two, the

increased tax cost of owning forestland, and three, the effect on long-term productivity of America's only natural renewable resource.

SIMPLIFICATION AND FAIRNESS

Obviously the smoke screen of tax simplification has long lifted. This act is neither simple nor fair.

Under the Tax Reform Act of 1986, forest land owners are placed into three classifications, and each class must still determine whether to maintain capital gains tax status on timber or timberland sales.

For example, a forest landowner approaching retirement—we have heard much about this today, I was very pleased to hear that from the other speakers, because this is not unusual since 50 percent of the forest landowners are 50 years of age or older, and this typical landowner faces the following problems. In all probability, he has made infrequent timber sales and may be holding timber for his retirement. He therefore, would probably be classed as a passive owner and required to capitalize all management costs associated with his timberland, however, there are exceptions, such as the ability to deduct up to $25,000 of losses attributable to rental real estate activities in which the taxpayer actively participates, and if his gross adjusted income does not exceed $100,000.

Gentlemen, I put that example in as pointing out the absurdity of the rules and the exceptions that have been put forward, not only by the law that was enacted, by the rules enacted or put forth to administer the law. As a matter of fact, probably timberland would not be included under the rental income exclusion.

A worse alternative would be for the landowner to be classed as an investor, in which case, because he is not a corporation, he would be allowed to deduct only those expenses which exceed 2 percent of his income. Therefore, 2 percent of his management costs would be permanently lost and would never be recovered by him, even in the event of asset sales.

To continue this example, due to corporate restructuring in America, such as a hostile takeover, our landowner loses his job, or if he is lucky he retires. In either case, our landowner, with little or no other income, and ample time on his hands, becomes more involved in his tree farm. He now becomes an active participant, most people say with good results. We say with onerous, but largely unknown consequences. As a sole proprietor, he must pay a self-employment tax of 12.3 percent unless his sales qualify as capital gains. Capital gains in name only, because remember, the tax rate is now the same for ordinary income and capital gains income. To qualify for capital gains, he must retain an economic interest. A retained economic interest simply means he must put himself completely at the mercy of timber buyers. That is, he must sell timber to a buyer, allow the buyer to cut it, remove it from his property to the buyer's place of business so the buyer can determine the quantity and, thus, value of timber for which he must pay the landowner. In our experience, this advantage to the buyer is in the range of 15 to 30 percent of the value of the timber sold.

Our tree farmer thus has two options. One, sell without capital gains and pay 12.3 percent self-employment tax plus 28 to 34 percent Federal income tax, plus State income tax, or, two, he can sell with a retained economic interest, and give 15 to 30 percent of his timber value to the buyer—a hidden tax—plus 28 to 24 percent Federal income tax, plus State income taxes.

This is not a too farfetched example of the simplification and fairness of this act.

INCREASED COST OF OWNING TIMBERLAND

Quickly to discuss the increased cost of owning timberland which we have heard much about, the literature, without exception, indicates that the after-tax cost of production has increased and the after-tax income has decreased.

The Atlanta Federal Reserve even recognized the impact in its prestigious "Economic Revenue" in May of 1988 stating, "This change essentially raises the overall tax burden and lowers the after-tax returns from investing in timber." This magnanimous statement was made after an example indicating a 40 percent increase in tax burden. Ironically, the Fed stated in the same article that "creation of the Conservation Reserve Program will apparently help offset any drop" (in forest management). One multimillion dollar Federal program offsetting another multimillion dollar Federal decision to raise taxes.

As a sidelight, what we have done is raise one landowner's taxes 50 to 200 percent, and to balance the total picture we have given other landowners the opportunity to make 50 percent returns on timberland investments, so the total picture on a national basis may balance, but it wreaks havoc in individual lives and is unfair.

Now, let me make one other comment. More dramatically, the University of Georgia computed that the value of an acre of typical Southern timberland decreased 112 to 148 percent, depending on the classification of the landowner. This translated into 11 to 17 percent reductions in the expected return from timberland investments, yielding investment returns in the range of 5.2 to 5.8 percent. These are nominal noninflation adjusted returns. How many in this room will line up for a 5.2 percent, 10- to 15-year return, when 90-day T-Bills are yielding at or above 9 percent?

LONG-TERM IMPACTS ON TIMBERLAND PRODUCTIVITY

Finally, on the long-term impact of productivity, the general belief, which is undisputed in this group, and in the literature, is that the increase in the after-tax cost of production and lowering the after-tax income will result in less intensive timber management and investment levels.

An increasing database that we have heard much about this morning indicates that the Southern forest resource is essentially a nonmanaged resource, even in the presence of more favorable tax policies of the past 40 years. Supporting data for this conclusion includes, one, a decline in the number of small trees in our forest, two, dramatic increases in hardwood acreages versus pine acreage, three, reduction in growth in the Piedmont regions of the South, and four, increases in mortality. I cannot stress too much, gentle-

men, these are symptoms of an unmanaged forest resource. As a matter of fact, those islands of well-managed forests which can occasionally be found in the South are not experiencing these problems. The problems I have identified are problems of lack of management.

If forest management has been inadequate with favorable tax laws, can anything happen with disincentives from current tax laws other than the health and productivity of Southern forests to continue to decline?

CONCLUSION

In conclusion, if the purpose of the act was to discourage investment in timberland, it has been a resounding success. However, if, as we suspect, the problem is one of guilt by association—tax shelters are bad, therefore, all capital gains are bad—then corrective action is clearly called. Such action should have three objectives:

First, the long-term management of healthy forest ecosystems must be of paramount importance. Tax law must not increase the after-tax cost of production. That will surely lead to less productive and less healthy forests.

Second, simplification is paramount. There is no justification in timberland ownership and investment to differentiate between active, passive, trade or business and/or investor.

Third, the hidden tax of "retained economic interest" is archaic and inappropriate in timberland ownership and investment decisions and puts the small landowner at a significant economic disadvantage to timber buyers. This inequity should be removed.

Thank you.

Senator FOWLER. Thank you, Mr. Chambers. [Applause.]

[The prepared statement of Mr. Chambers and his chart, figure 1, "Change in Number of Trees" follow:]

EFFECT OF TAX LAW ON TIMBERLAND INVESTMENTS AND MANAGEMENT

REMARKS BY:
Robert G. Chambers
Vice President and Manager of
Timberland
First Wachovia Investment Management
Atlanta, Georgia

March 13, 1989

I would like to begin my remarks by discussing some important impact of the 1986 Tax Reform Act (TRA) on forest resources which are already apparent.

1. The smoke screen of "tax simplification and fairness have been removed. The act is neither simple or fair.

2. The tax cost of owning, growing and managing America's renewable resourse has increased significantly.

3. The increased cost is disproportionately placed on middle income taxpayers, those comprising the majority of forest landowners.

4. The act penalizes all long-term investment and especially forestry with its extended period between the heavy investment at planting and the revenues at harvest time.

5. The act substantially increases record-keeping cost, requiring greater involvement by professionals. Good for accountants and foresters, but costly for landowners.

6. The psychological effect of frustration and anxiety as forest owners worry about whether a contemplated act is active, passive, trade or business, or simply an investment, and what the consequences of that action will be is difficult to quantify. The effect, however, is real and will impact the productivity of America's forest resources in a very real and negative manner.

The six factors above relate to three distinct impacts of TRA; 1). Simplification and fairness, 2). Increased tax cost of owning forestland, and 3). Effect on long term productivity of America's natural renewable resource.

SIMPLIFICATION AND FAIRNESS:

Under TRA, forest landowners are placed into three classification and each class must still determine whether to maintain capital gains tax status on timber and or timberland sales.

For example, a forest landowner approaching retirement, not uncommon since approximately 50% of timberland owners are over 50 years of age, faces the following problem. In all probability, he has made infrequent timber sales and may be holding timber for his retirement. He therefore, would probably be classed as a passive owner and required to capitalize all management cost associated with his timberland, however, there are exceptions, such as the ability to deduct up to $25,000 of losses attributable to rental real estate activities in which the taxpayer actively participates, and if his gross adjusted income does not exceed $100,000. Rules are not clear regarding this point, and possibly timberland rentals would not allow the landowner to pass the materially participating test.

A worse alternative would be for the landowner to be classed as an investor, in which case, because he is not a corporation, he would be allowed to deduct only those expenses which exceed 2% of his income. In other words, the law simply and effectively states that 2% of his forest management expenses would be permanently lost and would never be recovered.

Due to corporate restructuring, such as a hostile takeover, our landowner loses his job, or if he is lucky reaches retirement age. In either case, our landowner, with little or no other income, and ample time, becomes more involved in his tree farm. He now becomes an active participant with especially onerous, but largely unknown consequences. As a sole proprietor, he must pay self employment tax of 12.3% unless his sales qualify as capital gains. Capital gains in name only, because remember, the tax rate is now the same for ordinary income and capital gains income. To qualify for capital gains, he must retain an economic interests. A retained economic interest simply means he must put himself completely at the mercy of timber buyers. That is, he must sell his timber on a pay as cut contract, allowing buyers to cut his timber and then remove it to the buyers place of business so the buyer can determine the quantity and thus value of timber for which he must pay the landowner. In our experience, this advantage to the buyer is in the range of 15% to 30%.

Our Tree Farmer thus has two options; 1). sell without capital gains and pay 12.3% self employment tax plus 28% federal income tax plus state income tax, or 2). sell with a retained economic interest and give 15% to 30% of his timber value to the buyer (a hidden tax) plus 28% federal income tax and state income tax.

This is a not too far fetched example of the simplification and fairness of the TRA. Is this the system you which the small timberland owners who are your constituents to operate under?

INCREASED COST OF OWNING TIMBERLAND:

Extensive review of literature reveals that independent study by various and diverse groups found, without dissension, that TRA lowers returns by increasing after-tax production costs and lowering after-tax income, a double whammy. Unfortunately, this was the clear intent of the law. The purpose was to prevent people from investing in largely passive ventures (tax shelters) solely to offset other taxable income. However, as observed by Professor William Hoover of Purdue University, "The broad brush used to paint restriction on 'tax shelters' also tainted the picture for productive investments such as timber investments."

The Atlanta Federal Reserve even recognized the impact in its prestigious Economic Review in May of 1988 stating, "This change essentially raises the overall tax burden and lowers the after-tax returns from investing in timber." This statement came after an example showing a 40% increase in tax burden. Ironically, the Fed stated in the same article that, "creation of the Conservation Reserve Program will apparently help offset any drop" (in forest management). One multi-million dollar federal program offsets another multi-million dollar federal decision to raise taxes.

More dramatically the University of Georgia computed that the value of an acre of typical southern timberland decreased 112% to 148% depending on the classification of the landowner. This translated into 11% to 17% reductions in the expected return from timberland investments, yielding investment returns in the range of 5.2% to 5.84%. How many in this room will line up for a 5.2% return when 90 T bills are yielding over 9%?

LONG TERM IMPACTS ON TIMBERLAND PRODUCTIVITY:

The general belief is that increasing the after-tax cost of production and lowering the after-tax income will result is less intensive timber management and investment levels. One must consider the long--term impacts of these actions.

An increasing data base indicates that the southern forest resource is essentially a non-managed resource even in the presence of more favorable tax policies of the past forty years. This transcends ownership boundaries, with all ownership classes inadequately managing their timberland resources in response to external factors. Supporting data for this conclusion includes, 1). a decline in number of small trees (Figure 1); 2). dramatic increases in hardwood acreage in lieu of pine acreage; 3). reduction in growth in Piedmont regions; and 4). increases in mortality. These are symptoms of an unmanaged forest resource. As a matter of fact, those islands of well-managed forest that can occasionally be identified are not experiencing these management problems.

Under TRA, as already inadequate forest management activities are restricted, due to increasing tax cost and reduced income

levels, the health and productivity of southern forests will continue to decline.

CONCLUSION:

If the purpose of TRA act was to discourage investment in timberland, it is a resounding success. However, if, as we suspect, the problem is one of guilt by association (tax shelters are bad, therefore, all capital gains are bad) then corrective action is clearly called. Such correction in TRA should have three objectives:

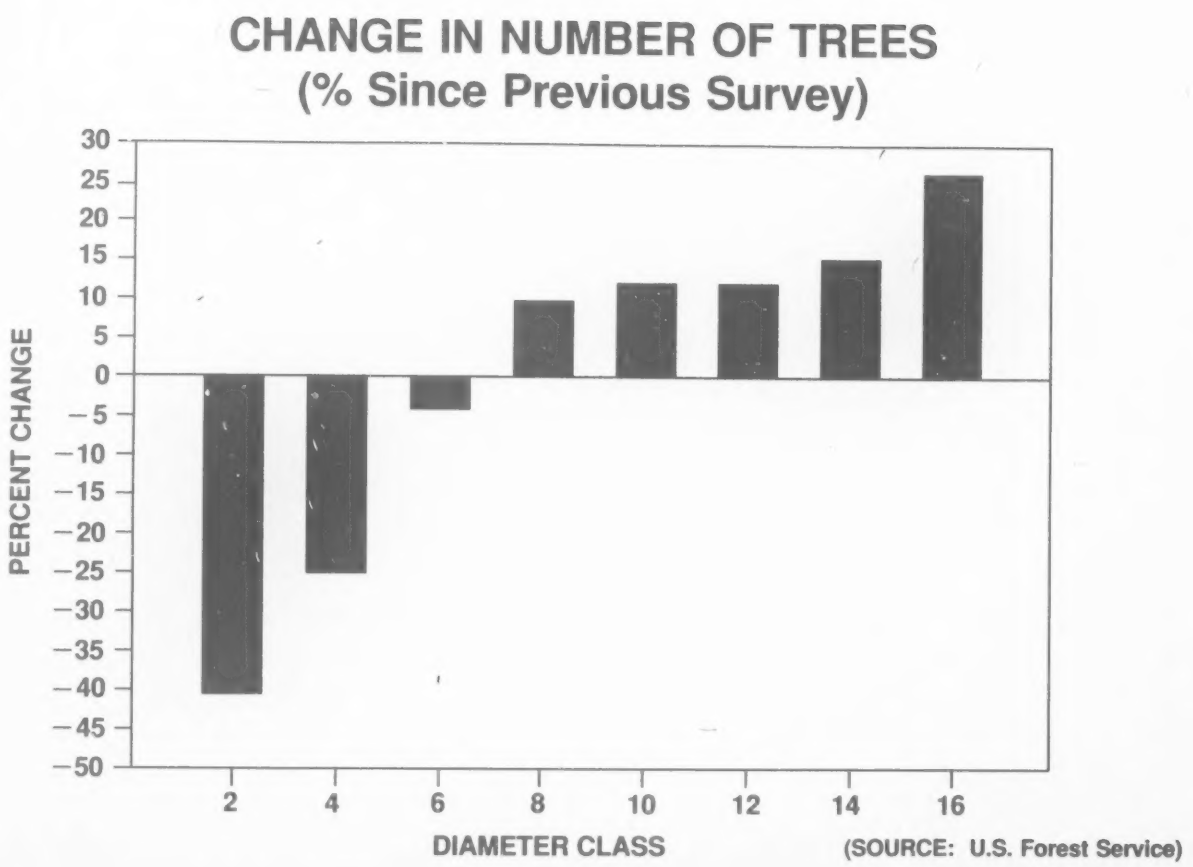
1. Long term management of healthy forest ecosystems must be of paramount importance. Tax law must not increase the after-tax cost of production and therefore reduce after-tax income. This combination will surely lead to less healthy and productive forests.

2. Simplification, there is no justification in timberland ownerships and investment to differentiate between active, passive, trade or business, and\or investor.

3. The hidden tax of "retained economic interest" is archaic and inappropriate in timberland ownership and investment decision and puts the small timberland owner at a significant economic disadvantage to timber buyers.

(Figure 1.--Change in Number of Trees (percent since previous survey follows:)

Figure 1


CHANGE IN NUMBER OF TREES
(% Since Previous Survey)
PERCENT CHANGE
30
25
20
15
10
5
0
−5
−10
−15
−20
−25
−30
−35
−40
−45
−50
2
4
6
8
10
12
14
16
DIAMETER CLASS
(SOURCE: U.S. Forest Service)

Senator FOWLER. Mr. Walter Jarck, corporate director of Forest Resources for the Georgia-Pacific Corporation.

STATEMENT OF WALTER JARCK, CORPORATE DIRECTOR OF FOREST RESOURCES, GEORGIA-PACIFIC CORP., ATLANTA, GA

Mr. JARCK. Mr. Chairman, distinguished panelist: I am the corporate director of Forest Resources for the Georgia-Pacific Corporation, headquartered in Atlanta. In the few minutes I have, I plan to discuss the importance of Georgia-Pacific and the forest products industry to the economics of Georgia and the South. I hope also to discuss our concerns that we share with nonindustrial private landowners, concerns that are making growing trees less and less attractive. Since I am here to talk about the plight of the private landowner, this will include touching on the environmental issues as well as the tax issues, and how the impacts will be felt by all of us.

Our company, as you well know, is one of the country's leading forest products companies in sales volume, and is the largest timber owner in Georgia. In Georgia, we own over 827,000 acres and lease or contract another 70,000 acres from individuals. Besides a joint ownership in our headquarters building in Atlanta, we have a total of 24 manufacturing plants in Georgia. A few of our plant locations are: Brunswick, Monticello, Warm Springs, Madison, Vienna, Claxton, Ellabell, Warrenton, Sterling, Pearson, McRae, Savannah, Albany, Marietta, Peachtree City, and LaGrange. We also have six wholesale distribution centers and two research labs. Our payroll in Georgia is almost $200 million annually for approximately 6,700 employees. Our investments here total more than $1 billion. These people and investments all are directly involved in forestry, forestry products, and closely related activities. Our activities have an enormous multiplier effect because of the independent loggers and timber suppliers and suppliers of equipment, parts, and other materials and services who support our manufacturing and sales.

So much for the Georgia-Pacific statistics in Georgia. Since Georgia-Pacific is but one of many companies in this important industry, and since this industry is so important to the economics of this State, let me summarize for you the Georgia forest products industry. There are 15 pulp and paper mills, 176 sawmills, 18 veneer and plywood mills, 222 yards dealing in pulpwood—incidentally, Georgia is the No. 1 pulpwood producing State in the country—65 percent of all dollars spent last year, in the State, in capital investments were in this forest-related sector alone. Supporting this manufacturing industry are some 23.7 million acres of commercial forest. The forest industry owns less than 6 million acres and public landownership is a mere 1.6 million acres. This leaves 16.2 million acres, or 68 percent owned by nonfarm individuals, by farmers, and by small corporations. The U.S. Forest Service's "Fourth Forest Report" issued last year listed timber and forestry as the No. 1 industry in the State of Georgia. In fact, it is first in 6 of the 12 Southern States. Delivered value of Georgia forest raw materials to the plants in 1984 was estimated at $1 billion. This

converts to almost $9 billion annually when you consider the value added multiplier effect.

The landowners rely on ready markets to purchase their timber and products, and the industry relies on these timber growers for a steady supply of raw material.

The western U.S. timber shortfalls being brought about by such public concerns for spotted owl, wilderness preservation, roadless areas and wildlife withdrawals already have closed 49 sawmills and panel plants. This is in Washington and Oregon. These issues have forced the layoffs of over 3,500 employees during the past 2 years. The resulting reduction in available timber supplies have caused short-term escalation of stumpage prices. What is really happening is that the west coast timber is slowly pricing itself out of the market. We are already seeing lower-priced products from Brazil, Chile, and New Zealand entering our ports.

Here in the East, landowners also are being hammered with environmental concerns for woodpeckers, wetlands, water and air issues that could result in less timber availability. Timber producers were also hurt by changes that were made in the tax law in 1986, which you have been hearing about. The future of our industry is dependent upon these resources, so we have a major stake in wise use and protection of our environment. Here in Georgia and the South where the nonindustrial landowners own almost 70 percent of the timberlands, our industry's concern is that the long-term wood supply could be drastically affected by these environmental and tax considerations. Future shortfalls may result in escalating costs which could price our products out of world markets.

Mr. Chairman, over the years this State has developed a strong——

Senator FOWLER. Let me interrupt you there, Mr. Jarck.

Mr. JARCK. Sure.

Senator FOWLER. Since on that point I was listening very carefully.

Are Georgia-Pacific's, are your holdings in our State managed in any way for wildlife?

Mr. JARCK. Wildlife is a secondary issue. We manage for production of the various wood products. We find that turkey, duck and deer populations also are enhanced by good forestry practice, and we find that hunters especially are interested in leasing our lands because of these wildlife products that are available.

Senator FOWLER. But you are not—I am trying to ask the question so it does not sound negative. I would assume that with the size of the company that you are experimenting with different methods of harvesting as well as replanting in order to minimize damage to the wildlife, are you not?

Mr. JARCK. We really do not see that damage to the wildlife that you are talking about. We do manage our forests and have a stair-step forest. With such a forest you have some areas that are being clear-cut, or being seed tree cut; you have other areas that have young regeneration; you have areas on up to a 35-year rotation, so we theoretically have 1/35th of our stands in each of these age classes.

By doing that you actually are enhancing wildlife because you are bringing that canopy, that food area down to the ground, and

you are letting the foraging animals gain access to that. By having small clear-cuts or small harvests throughout the forest you are actually moving game around, and the game actually benefits by such good forestry practices.

Senator FOWLER. Excuse me. I will let you continue your statement.

Mr. JARCK. Senator, over the years this State has developed a strong position in forestry, markets, and income because we have had a fairly level playing field. This field has been tilted as a result of environmental regulations and changes in our tax law. The effects of the tax law changes are just beginning to be felt. Because of the long-term nature of timber, timberland owners started under one set of rules and now must play under another, their reaction may be slow, but it may severely impact the economy and wood supply in the future. What we are seeing are owners beginning to liquidate their investments, many do not plan to reforest or replant. So, Senator, this balance of entrepreneurial forest landowners and industry-supplied markets appears to be changing in ways that will undermine the long-term health of our industry.

Gentlemen, I ask your help in two areas. That you work toward achieving adequate and continual timber supplies on all forests, public and private, by balancing the needs of our interests with the face of the constant and very vocal environmental voices. We also urge you to carefully consider the needs of the timber growing industry when considering tax legislation during the coming legislative session. I ask you to publicize these needs for favorable treatment for the nonindustrial landowner among your colleagues in Washington. These changes are important not only in Georgia, but the entire United States. Such positive action by you and by Congress will assure the welfare of rural tree farmers as well as the wide variety of businesses and industries that are so dependent on a steady and economical wood supply into the future.

If you will allow me, if you will hang in here with me one more minute or so—this is the end of my prepared statement—I would also like to tell you that I am a tree farmer also, and that tree farming has helped four of my five children go through college, and I hope the last one will also be able to benefit by my tree farming.

In my opinion there has been a real break in faith because over the 40 years these timber growers were promised reduced taxes, they were in the 10 to 25 percent range if they planted trees and grew timber. Now in many instances, and this is the case with me, the trees are ready to be harvested. While Congress lowered everyone's taxes, all individuals to 28 percent, it raised the rates on timber income (the 10 to 25 percent that I mentioned) to 28 percent.

I can agree that Congress needed to improve the tax laws. Timber growing, with its many risks and environmental issues and pressures, long-term dedication, cannot be considered a tax loophole. Timber growers are both blue and white collar, they work for salaries. They are not the rich trying to cheat the IRS, and they certainly are not passive operators or passive investors.

These tree farm owners are beginning to liquidate their investments. I believe that for a large part this is due to being designated in these passive categories, so, Senator, this beautiful balance that

we talked about earlier appears to be deteriorating because of the very short-sighted treatment by our Federal Government.

Senator FOWLER. Thank you, Mr. Jarck. [Applause.]

Mr. Peter Kirby, the southeast regional director of the Wilderness Society.

STATEMENT OF PETER KIRBY, SOUTHEAST REGIONAL DIRECTOR, THE WILDERNESS SOCIETY, ATLANTA, GA

Mr. KIRBY. Thank you, Mr. Chairman.

Conservation groups support the goal of increasing levels of timber production from America's private forestlands, particularly the nonindustrial private ownerships in the Southeast. With proper environmental protection, increased timber production from the South's nonindustrial private woodlands can produce a number of benefits for conservation. This can reduce, for example, the pressure on public forests to meet the country's growing needs for wood.

In addition, that means that the national forests which are supposed to be managed for other multiple uses in addition to timber, can be managed for values that are often not provided on private lands, such as opportunities for old growth, wildlife habitat, high quality cold water fisheries, outstanding mountain beauty and wilderness.

Another benefit of managing these private forestlands for timber is that some environmentally sensitive areas are kept in forest cover rather than cropland.

The conservation community shares many of the concerns expressed today about the detrimental effects of the change in the Tax Reform Act of 1986. With the repeal of preferential rates on capital gains, and thus a higher tax burden, there is a significant risk that owners may forgo reforestation and other conservation measures. Thus, the Wilderness Society supports the restoration of preferential tax benefits and full expense deductions, with the goal of encouraging private owners to invest in long-term timber production. To further this goal, we also urge the use of a required holding period substantially longer than the 6-month requirement specified before the Tax Reform Act of 1986.

To protect the environment, we also support strengthened Federal, State and private programs to help woodland owners carry out sound forestry practices.

An increase in timbering in private woodlots can carry with it risks to water quality, wildlife habitat and other important natural values. Key to mitigating these adverse impacts is the use of proper methods for road construction and timber harvesting and prompt reforestation.

Through its State and private forestry branch the U.S. Forest Service can provide support for improved management on these non-Federal forestlands. However, as you know, the Federal funding for State and private assistance through the Forest Service has been cut 44 percent in constant dollars since 1979. Congress could find the needed funds for these programs readily enough by reducing expensive timber-sales-below-cost on the national forests and halting destructive road building into the public's wild areas.

Finally, we urge Congress to link forest tax preferences with sound forestry practices in compliance with approved local plans. In other words, we urge that forestry tax benefits be provided to the landowner only in compliance with a locally approved plan for reforestation and protection for water quality, fish and wildlife habitat, wetlands and soils.

With increased funding for State and private forestry, planning assistance could be provided to all landowners in need. We also urge that the Forest Service be directed to work with the States in developing guidelines for plans and in reviewing the adequacy of the guidelines.

In conclusion, Mr. Chairman, the conservation community shares the many concerns expressed today about these damaging tax changes. In fact, last fall, when the environmental community presented its package of recommendations to President Bush, there were two major planks on exactly these points about changes in the Tax Code and more aid for State and private forestry programs, and with your permission, Mr. Fowler, I would like for those to be put in the record.

We pledge our help in your efforts to seek these needed solutions. [Applause.]

[The prepared statement and attachments of Mr. Kirby follow:]

THE WILDERNESS SOCIETY

SOUTHEAST REGION

STATEMENT OF PETER KIRBY, SOUTHEAST REGIONAL DIRECTOR OF THE WILDERNESS SOCIETY, ON TAX ISSUES AFFECTING THE TIMBER INDUSTRY BEFORE THE SENATE AGRICULTURE COMMITTEE'S SUBCOMMITTEE ON CONSERVATION AND FORESTRY, MARCH 13, 1989, MACON, GEORGIA

Mr. Chairman, The Wilderness Society, with its 250,000 members nationwide and over 4,000 in Georgia, supports the goal of increasing levels of timber production from America's private forestlands, particularly the nonindustrial private ownerships in the Southeast. With proper care, the private forests in the Southeast -already the nation's woodbasket- can increase production and enjoy greater economic and environmental benefits.

Towards this goal, we support tax incentives to make it attractive for nonindustrial forest owners to invest in long-term timber production. To protect the environment, we also support strengthened federal, state and private programs to help woodland owners carry out sound forestry practices.

Finally, we urge Congress to link forestry tax preferences with sound forestry practices in compliance with approved local plans. As we shall discuss below, these changes, along with positive programs already underway such as the Conservation Reserve Program, could yield a brighter economic and environmental future for the Southeast and the country as a whole.

1. We support increasing levels of timber production from America's private forestlands, particularly the nonindustrial private ownerships in the Southeast. Almost 60% of the country's commercial forestland, a total of about 278 million acres, is owned by farmers, individuals, institutions and corporations collectively called non-industrial forest owners. Most of these lands, 164 million acres, are found in the Southeast, where markets are close, lands are generally productive and growing seasons are long. According to USDA's The South's Fourth Forest, (1988) over 50 million acres of these forests in the Southeast could yield an additional 2.3 billion cubic feet of wood per year and return to their owners 4% profit annually above inflation.

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With proper environmental protection, increased timber production from the South's non-industrial private woodlands could produce a number of benefits. This could reduce pressure on public forests to meet the country's growing needs for wood. With less than 20% of the country's commercial timber base, public forests already produce more than their share of the country's annual harvest, almost 25% of the total. (In the Southeast, the national forests contain only around 5% of the commercial timberbase and provide a very small share of the regional supply.) These lands are supposed to be managed for other multiple-uses in addition to timber and, in the view of many conservationists, cannot sustain further increases. Further, these public forests provide the nation's opportunities for old-growth habitat, high-quality fisheries, backcountry recreation, outstanding visual beauty and wilderness that generally are not available on private lands.

Another benefit of managing these private forestlands for timber is that some environmentally-sensitive areas are kept in forest cover rather than cropland. The Soil Conservation Service has identified tens of millions of acres of forestland with likely potential for conversion to environmentally damaging intensive rowcrop production. Fortunately, in Georgia and around the country, the Conservation Reserve Program is boosting tree-planting efforts on marginal farmland. It is vitally important to continue this program and to see that other federal policies, like taxation, also are consistent with providing for long-term forestry on fragile lands.

2. To achieve this goal, we support tax incentives to make it attractive for nonindustrial forest owners to invest in long-term timber production. Unlike annual agricultural crops, tree-farming requires decades of care and investment, from reforestation to stand improvement and final harvest, before a financial gain is realized. In the 1986 Tax Reform Act, Congress removed the preferential "capital gains" treatment for net income from the sale of timber held for six months or more, as part of its overall end to "capital gains" treatment. Net income from the sale of timber is now taxed as ordinary income, at rates generally higher than under "capital gains" treatment. The 1986 law also put limits on the annual deductibility of expenses for maintaining and improving stands of timber, particularly for so-called "passive" participants in forest management.

The Wilderness Society (1), the Natural Resources Defense Council (2) and the conservation community generally (3), all have serious concerns about the possible detrimental effects of these changes in the 1986 Tax Reform Act on our shared goal of supporting increased levels of environmentally-sound, sustainable timber production from

private, nonindustrial forestlands. With the repeal of preferential rates for capital gains and thus a higher tax burden, there is a significant risk that owners may forego reforestation and other conservation measures. The favorable tax provisions for timber that began in 1944 and lasted until 1986 have been widely credited for substantial increases in private timber production and reforestation.

The loss of preferential tax rates may already have resulted in greater sale of private woodlots for other uses and loss of timber management altogether. (4) In addition, as noted earlier, farmers might convert forest cover to rowcrop production on erosion-prone lands. As NRDC warns, this would "endanger the hundreds of thousands of acres planted with trees under current CRP contracts due to expire in the next decade." (p.22). Finally, the new distinction between "active" and "passive" participants for purposes of annual expense deductibility is quite complicated. The increased ambiguity may result in less timber stand improvement, for example, and thus reduced final yields.

For these reasons, The Wilderness Society supports the restoration of preferential tax benefits and full expense deductions with the goal of encouraging private owners to invest in long-term timber production. To further this goal, we also urge the use of a required holding period substantially longer than the six-month requirement specified before the 1986 law.

3. To protect the environment, we also support strengthened federal, state and private programs to help woodland owners carry out sound forestry practices. An increase in timbering on private woodlots carries with it risks to water quality, wildlife habitat and other important natural values. Key to mitigating adverse impacts is the use of proper methods for road construction and timber harvesting and prompt reforestation. Through its State and Private Forestry branch, the Forest Service can provide support for improved management on these non-federal forest lands. In 1986, the Forest Service and state foresters developed plans covering 3.8 million acres of private non-industrial lands. Yet these programs reach only a small fraction of the owners needing assistance.

However, federal funding for state and private assistance has been cut 44 percent in constant dollars since 1979; several state programs are also being cut. Congress could find needed funds readily enough by reducing expensive timber-sales-below-cost on the national forests and halting destructive roadbuilding into the public's wild areas.

Thus, The Wilderness Society urges Congress to recast budget priorities, provide more funds to states, and, in return, require state forestry programs to work toward

common objectives. Rather than simply passing federal funds through state governments, with little or no assurance that the nation reaps the benefit, we must ensure that states support, and have the means to support protection of water, wildlife habitat and sustainable forestry. Specifically, technical assistance must include guidelines for protecting forested wetlands and riparian habitat and forest management that protects wildlife of all kinds.

4. Finally, we urge Congress to link forestry tax preferences with sound forestry practices in compliance with approved local plans. As this Committee is well aware from its work on the last farm bill, the 1985 Food Security Act requires farmers to comply with an approved conservation plan in order to receive annual subsidies for crop production on sensitive lands. So too, the 1986 Tax Reform Act allows farmers to deduct only those soil and water conservation costs in compliance with approved plans. We urge Congress to apply this concept to private forestry.

The Wilderness Society urges that forestry tax benefits to a landowner be provided only where practices comply with a locally approved plan for reforestation and protection for water quality, fish and wildlife habitat, wetlands and soils. With increased funding for state and private forestry, planning assistance could be provided to all landowners in need. We also urge that the Forest Service and EPA be directed to work with the states in developing guidelines for plans and in reviewing the adequacy of the guidelines.

Experience in states with required forest practices indicates that the cost of compliance is modest. Compliance with these locally approved plans also means additional tax benefits that can offset any extra costs. Moreover, these plans are aimed at enhancing the long-term productivity of the land for timber and other uses, thus increasing the value of the land.

(1) New Directions for the Forest Service, The Wilderness Society (February, 1989).

(2) Taxing the Tree Farm, NRDC (May 1988).

(3) Blueprint for the Environment (November 1988).

(4) Hagenstein, A Challenge for New England: Changes in Large Forest Landholdings, Fund for New England (1988).

(Attachments follow:)

THE WILDERNESS SOCIETY

SOUTHEAST REGION

March 15, 1989

Wyche Fowler, Jr.
U.S. Senate
Committee on Agriculture
Washington, D.C. 20510
Attn: Bob Redding

Re: Timber Tax Issues Hearing

Dear Senator Fowler:

I appreciated the opportunity to testify at your hearing last Monday in Macon. As I mentioned in closing, the conservation community stands ready to assist in any way in pursuing needed changes in tax law. As you may know, we are also working this year, as in past years, to persuade Congress to maintain funding for the Forest Service's State and Private Forestry branch, which helps private landowners bring their forests into timber production.

Could you please add to the printed hearing record the enclosed pages from the "Blueprint for the Environment." These are the relevant recommendations that the conservation groups submitted to George Bush in late November. They provided the basis for the positions taken in our testimony.

Sincerely,

Peter Kirby

Peter Kirby

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Blueprint for the Environment

USDA-0.4

DEPARTMENT OF AGRICULTURE

ASSISTANT SECRETARY for Natural Resources and Environment

Forest Service

RECOMMENDATION

The Chief of the Forest Service should request funding to implement a forest resources planning program so that 25 million acres of private non-industrial forestland have forest resource and conservation plans by 1993.

- Individual plans should include reforesting following timber harvest and requirements that will protect and enhance unique features found on the land such as: wildlife and fish habitat, wetlands, soils, biological diversity, aesthetics and recreation.
- Only landowners with approved, environmentally sound plans would qualify for benefits which might include federal cost-share programs to reforest, technical assistance and tax benefits from timber harvesting.
- The Forest Service working with other concerned federal agencies, State Foresters and interested publics will develop national guidelines for forest resource and conservation plans.
- State Foresters will head state-level committees that would oversee this process and spell out specific guidelines. Others on the committee could include the Soil Conservation Service, the Extension Service, The Fish and Wildlife Service, State Wildlife and Fisheries Agencies, and Conservation Districts and other interested parties. Local committees will approve specific plans that follow state and national guidelines.

BUDGET RECOMMENDATION

F.Y. 90: **no change** F.Y. 91: **no change**

PRINCIPAL AUTHORIZING LEGISLATION

Cooperative Forestry Assistance Act of 1978 (P.L. 95-313)

CONGRESSIONAL JURISDICTION

House Authorizing Committee/Subcommittee
Committee on Agriculture
Subcommittee on Forests, Family Farms and Energy
Senate Authorizing Committee/Subcommittee
Committee on Agriculture, Nutrition and Forestry
Subcommittee on Conservation and Forestry
House Appropriations Subcommittee
Subcommittee on Interior
Senate Appropriations Subcommittee
Subcommittee on Interior and Related Agencies

RELEVANT STUDIES

Benfield, Kinsinger and Ward, **"Taxing the Tree Farm — Sensible Policies for Sensible Private Forestry,"** Natural Resources Defense Council, May 1988, Washington D.C.
Force and Lee, **"NIPF Landowner Survey for Northern Idaho — A Survey of Landowner Objectives,"** University of Idaho, Moscow, Idaho, September 1987
Jack P. Royer, **"Use and Effects of the Reforestation Tax Incentives and Cost Sharing in the South,"** Duke University, June 1987
Fesco, Kaiser, Royer, and Wiedenhamer, **"Management Practices and Reforestation Decisions for Harvested Southern Pinelands,"** Statistical Reporting Service, No. AGE5821230, Washington, D.C., December 1982
Cubbage, Skinner, Risbrudt, **"An Economic Evaluation of the Georgia Rural Forestry Assistance Program,"** University of Georgia, January 1985, Bull. No. 322

RELATED FEDERAL PROGRAMS

Conservation Reserve Program
Conservation Compliance
Forestry Incentives Program

PRINCIPAL SOURCES OF EXPERTISE

National Association of State Foresters — 202-624-5415
The Wilderness Society — 202-842-3400
Natural Resources Defense Council — 202-783-7800
American Forestry Assoc. — 202-624-5415
Forester Farmers — 404-325-2954
National Woodland Owners Association — 703-255-2300

IMPLEMENTATION STEPS

(1) Limit preferential tax rates to those gains on timber sales that accrue over 20 years or longer.
(2) Full annual deductions for ordinary and necessary forest management expenses.
(3) Require landowners utilizing these tax provisions to follow an approved forest resource management plan.

BUDGET HISTORY (in millions of dollars by fiscal year)

	87	88	89
Requested	0	0	0
Appropriated	5.3	5.0	5.0

* Forest Management included in RFA/Forest Management and Utilization

MANPOWER HISTORY (in F.T.E.'s by fiscal year)

Note: F.T.E.'s for '81 and '88 are for total Cooperative Forestry. Forest Management accounts for less than half in both years.

	81	88
Actual	206	102

Blueprint for the Environment

USDA-025

DEPARTMENT OF AGRICULTURE

ASSISTANT SECRETARY for Natural Resources and Environment

Forest Service

RECOMMENDATION

The Chief of the Forest Service should promote legislation that will grant a limited income tax benefit to private, long-term forest production and will secure full annual deductions for ordinary and necessary business expenses associated with long-term forest management to stimulate long-term, environmentally sound stewardship on private forestlands.

• Nearly three-fourths of the productive timberland in the United States, some 348 million acres, lies in private hands. Over 260 million acres of this land is held by a diverse assembly of almost 8 million non-industrial private foresters (NIPF). Government projections indicate that better management of lands owned by NIPFs could increase the country's annual net timber growth by some nine billion cubic feet, more than enough to meet foreseeable increases in demand for wood products. Such a course could bring significant environmental benefits, including reduced development pressure on public forests.

• A variety of economic barriers stand in the way of increasing production on NIPFs. These include lack of liquidity associated with long-term timber management, an exceptional degree of risk, and extra costs associated with small average stand size. To sensibly address the economic difficulties that hamper sound private forestry, preferential income tax rates should be instituted for gains on sales of timber held for 20 years or longer. This tax benefit will increase the rate of return from optimal forest management and thus improve forest management by NIPF. Better forest management can also be encouraged by adjustments made in the deductibility of forest management expenses. Full annual deductions of business expenses associated with long-term forestry management will foster investment in forest stand maintenance and other practices that increase the productivity of these lands.

• To prevent short-term exploitation of these changes, all tax benefits should be conditioned on proper stewardship practices and a holding period of 20 years or longer.

BUDGET RECOMMENDATION

F.Y. 90: Increase of $ 25 million F.Y. 91: Increase of $ 25 million

PRINCIPAL AUTHORIZING LEGISLATION

Cooperative Forestry Assistance Act of 1978 (P.L. 95-313)

CONGRESSIONAL JURISDICTION

House Authorizing Committee/Subcommittee
Committee on Agriculture
Subcommittee on Forests, Family Farms and Energy
Senate Authorizing Committee/Subcommittee
Committee on Agriculture, Nutrition and Forestry
Subcommittee on Conservation and Forestry
House Appropriations Subcommittee
Subcommittee on Interior
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RELATED FEDERAL PROGRAMS

Department of Agriculture Conservation Reserve Program
Conservation Compliance
Forestry Incentives Program

PRINCIPAL SOURCES OF EXPERTISE

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Natural Resources Defense Council — 202-783-7800
National Assoc. of State Foresters — 202-624-5415
American Forestry — 202-667-3300
Forest Farms — 404-325-2954
National Woodland Owners Association — 703-255-2300

IMPLEMENTATION STEPS

(1) Increase the budget request to $25 million for five years to be matched with state and local funds to improve forestland productivity and environmental quality. Withdraw funding from uneconomic sales of national forest timber to accomplish this at no increased cost.
(2) Implement strategies to reach nonindustrial forest landowners before they harvest their timber.
(3) Establish a mechanism that develops and implements locally approved forest resources management plans. This should be similar to Conservation Compliance (administered through SCS for farmers with soil erosion problems) but should include a broader range of resource specialists.
(4) Change Department regulations to allow only landowners with adequate forest resource plans to qualify for cost-share programs and technical assistance.

BUDGET HISTORY (in millions of dollars by fiscal year)

	79	81	83	85	87	88	89
Authorized							
Requested		*	*	*	0	0	0
Appropriated	*	*	*	*	5.3	5.0	5.0

* Forest Management included in RFA/Forest Management and Utilization

Senator FOWLER. Mr. Ray.

Mr. RAY. Mr. Chairman, I think this has been a great hearing. I would like to submit a point paper on capital gain tax for the record with your permission.

Senator FOWLER. Please.

[Mr. Ray's point paper on capital gain tax can be found on page 15.]

Senator FOWLER. Gentlemen, I also want to add my thanks for your testimony, the thoroughness of it, and as you have all been here all morning, it has been an extraordinarily detailed and helpful presentation of what has been done and what needs to be done to continue not only our forest products industry, our timber industry, our ecological responsibilities for those that come after as Mr. Chambers said, I think we have a record that can certainly make the case for those, for anyone in high public places or individual farmers, those who have eyes to see and ears to hear, and we will try to make that case.

Thank you very much for being with us.

Excuse me. Senator Pryor.

Senator PRYOR. I was not going to say anything until Senator Fowler made his remarks, but I would just like to say, Senator Fowler and my colleagues from the House, when we were driving down here this morning from Atlanta for the hearing to listen to the witnesses and the respective panels, I was saying "My goodness, how are we going to sit there from 9:15 to 12 o'clock or 12:15 listening to all these people," and I will tell you, the time has gone just like that [snapping fingers] and to me this has been a great education, and it has gone very quickly. The witnesses have been concise, they have been right to the point, all of you have, and I only hope that our colleagues when we get our transcript put together, Senator Fowler, will have the benefit of the facts and figures and the positions of those of you who have testified and those that you speak for.

Senator FOWLER. We will make sure of that.

Senator PRYOR. I wish, too, that there were some way to capture on paper the feeling in this room and some of the emotions that I think we have sensed here today in the audience and among the witnesses who have testified. I think it has been one of the finest hearings I have ever had the privilege of attending, and I hope we can take this and seize this opportunity and somehow or another make it count for good and somehow or another, maybe some miracle might occur and, who knows, we might even do something right. [Laughter and applause.]

Senator FOWLER. Ladies and gentlemen, my colleagues, I appreciate very much what Senator Pryor had to say, but we all do have to be back in Washington. I know that there are some here who had wished to testify representing different organizations and in your individual capacity, but obviously I hope you will agree, and Senator Pryor just said, we have had not only a fine hearing, but a great diversity of interests represented here.

I have to cut it off now after almost 3 hours in order to keep my commitments to my colleagues. Anyone who has a prepared statement—I know Mr. H.E. Rourk is here representing the Georgia Christmas Tree Association—your complete statement will be made

a part of the record, and anyone else who has a statement, the record will be left open. If you will bring it to us here at the front, we will make sure to include it.

To any other individual farmers who have spent the morning with us, I am grateful for your attendance and hope that you will write me in any detail in reaction to anything that you have heard this morning, or suggestions. If we are able to convince the administration that every day that we wait in changing the policy causes us severe harm to our national interest in its environmental responsibilities, its fiscal responsibilities and its generational responsibilities, so any suggestions that you have to help us make that case with the specifics coming out of your own family and your own business, certainly not only I implore you to let me know about it, but I will also make your comments and your letters if you wish part of our public record.

Thank you all for being here. The hearing is adjourned. [Applause.]

[Whereupon, at 12:13 p.m. the subcommittee adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

STATEMENT
by
H. E. Ruark

Georgia Christmas Tree Association, Inc.

Macon, Georgia

March 13, 1989

My name is H. E. Ruark. I operate a family Christmas Tree, Nursery, and Vineyard farm in Morgan, County, Georgia. I appear before you as the representative of the Georgia Christmas Tree Association, Inc.

Presently we have 335 members in our Association. Three years ago our membership exceeded 500 members. Keen competition from imported and artificial trees, high production cost with extensive labor costs, caused many to abandon their Christmas tree farming.

Today, our Georgia Association is stronger with serious growers trying to produce high quality Christmas trees so that we may meet the keen competition from imported and artificial trees. And also capture part of the Florida and surrounding states market.

Christmas tree farming is somewhat unique in Georgia and most southern states as compared to the large tree farms in the Lake States and West Coast. Our local farm operations are predominantly a member and spouse, usually a Mom and Pop enterprise. Most of our members are retirees who wish to remain active and have a means of supplementing their income.

Over seventy percent of our Georgia membership operate a choose and cut farm. These farms provide an opportunity for an urban family to recapture the old Christmas tradition of going into the woods to choose and cut their own special Christmas tree. Most of these farms are located near high population centers.

The remaining thirty per cent of our Georgia farms are in the more rural areas and grow trees for Wholesale. The Wholesale trees are shipped to retail lots, supermarkets civic clubs and garden centers in urban areas.

Nationwide, 35 million households buy the real Christmas tree each year. Our National and State Associations are striving to increase our share of sales each year. In Georgia, 800,000 households use real Christmas trees. Our Georgia Association membership supplies 400,000 of these trees. The remaining 400,000 Christmas trees are shipped into Georgia from large out-of-state farms.

Our Georgia Christmas Tree Association, Inc., was founded in 1960. We have made tremendous gains in the last twenty-nine years. In the mid-1950's, Congress amended the tax laws to allow Christmas

trees to be included under Section 631A&B. To be eligible for capital gains tax, a Christmas tree grower must grow his trees 6 years from seed. This same regulation holds today.

One of my purposes for appearing before you is to request that the holding period for Christmas trees be changed to 4 years from 6 years. This would benefit the local Southern growers as much as it does the Northern and Western growers.

The principal Christmas tree grown in the South, is the Virginia pine. We can grow our Virginia pine ready for the market in 4 to 5 years. Whereas, trees grown in the Northern and Western states, take 6 or more years to harvest. On the surface, one could assume that the Southern grower has a distinct advantage. This is not the case.

The Northern and Western grower is eligible for capital gains tax whereas, the Southern grower is not. At the market place, this difference is most important. The Northern and Western growers for many years prior to the Tax Reform Act of 1986 enjoyed the 60% exclusion provided in the capital gains tax law. Consequently, these large growers became well established in Atlanta and all large population centers.

The 1986 Tax Reform Act eliminated the 60% exclusion on capital gains from forestry and other programs. Because of the tremendous investment in growing a crop of Christmas trees, our Association request that the 60% exclusion be reinstated and that the holding time for Christmas trees be reduced to four (4) years so that our Christmas trees will have equal advantage as those grown in the North.

The growing season in the South is longer than in other climates. This does cause faster growth each year but it also adds to the expense of growing the Virginia pine and other Southern species. Weeds, disease, insect control and twice a year shearing, make the growing of Virginia pine much more expensive than Northern species. A study at Louisiana State University reports that 291 man-hours are required to produce one acre containing 1,000 trees in five years. In the five-year period, each tree was visited 56 times. As you can see Christmas tree growing in the South is labor intensive. Additionally, our trees are more susceptible to insects and diseases. We begin spraying for scales on our pines in February. Spraying for these and other insects may continue into November. Our humid climate is ideal for the spread of diseases. Our Southern growers are battling weeds for nine months of the year, whereas the Northern grower has about five months to control his weeds.

The Virginia pine reaches its peak performance at age four or five years. Moreover, after age five, the Virginia pine rapidly loses much of its vigor and immunity to disease and other conditions. During the sixth growing season, the needles on the lower third of the tree begin to thin. Consequently, the limbs and trunk become

visible thus degrading the tree. As the tree ages, degradation becomes more pronounced.

Obviously, a Virginia pine must be marketed by the age five if a profit is to be expected. If the grower fails to market his trees in a short time frame, he is soon out of business.

For the Southern Christmas tree grower, high production cost, the short opportunity to sell his trees and not being eligible for capital gains, raises his risk far greater than his counterpart from North Carolina, the Lake States and the West Coast.

If Congress will reinstate the 60% exclusion in the capital gains tax and reduce the holding period to four years, our Southern growers will have an equal opportunity for profit and growth with Christmas tree farmers elsewhere.

Regeneration of forest trees is essential for forestry in the South. Where there are programs encouraging the planting of long term forest trees, we in the Christmas tree industry ask to be excluded from these programs. We have too many Christmas trees growing at present and do not need federal assistance. We do need the 60% exclusion and holding period of 4 years in the capital gains tax laws.

Thank you,

Department of Agriculture
AGRICULTURE BUILDING CAPITOL SQUARE
ATLANTA, GEORGIA 30334

Thomas T. Irvin
Commissioner

Statement of Commissioner of Agriculture Tommy Irvin
For the Senate Agriculture Committee's
Subcommittee on Conservation and Forestry
Field Hearing on the Timber Industry
March 13, 1989

I appreciate the opportunity to enter my comments for the record regarding the impact of the 1986 Tax Reform Bill on Georgia's timber industry.

Unlike many agricultural endeavors, it takes a minimum of 15 to 20 years for a stand of timber to develop into a marketable crop. During the growing process, the landowner must pay local ad valorem taxes on the real property, as well as the value of the standing timber.

In Georgia, ad valorem taxes for forest land are based on the "highest and best" use rather than current use. As a result, our landowners pay the highest forest land ad valorem taxes in the South.

This tax burden was increased by the implementation of the Tax Reform Act of 1986 which eliminated the capital gains exclusion for timber. As a result of this legislation, Georgia's forest farmers are now forced to pay taxes on the sale of their harvested timber as if it were ordinary income. Even though the value of timber has increased during the last two years, the loss of the capital gains exclusion, combined with the high local taxes, has caused Georgia landowners to receive even less return for their investment than in 1986.

-continued-

EQUAL OPPORTUNITY EMPLOYER

Although the Georgia Forestry Commission continues to lead an active reforestation campaign each year, which I strongly support, I understand that the result of heavy taxation has caused uncertainty among landowners and less than one third are replanting trees once they are harvested. Instead, many landowners are searching for shorter term, safer investments which require less initial capital outlay and a greater cash return.

For years Georgia has been a leader in many aspects of forestry -- we lead the nation in pulpwood and naval stores production and are second only to Oregon in commercial forest acreage. Our state's forests provide values in recreation, tourism, wildlife, water quality protection and real estate enhancement. With my previous background in the lumber industry, I also can appreciate the values added through processed and manufactured wood products such as lumber and pulp and paper production.

With some 80,000 Georgians depending on our forests and forest products for their livelihoods, this industry is a vital part of Georgia's economy. Since our forests are one of the few renewable resources we have available, I strongly support any legislation which will benefit forest farmers and landowners and encourage them to continue planting trees.

I urge your committee to carefully consider reinstating former capital gains exclusions or to develop other policies, such as the passive activity loss regulations, which might keep forestry a viable industry in Georgia and the South.

TIMBERLAND POSITION PAPER

By: Harold C. Kendrick, Jr. (Consulting forester and land manager.)
March 13, 1989

1. Most timber in Georgia and in our southeastern United States is grown on a 25 to 35 year rotation. Yet recently passed Capital Gains taxes of 28% Federal and 6% State (a 15.6% rise) plus ever higher yearly advalorem taxes are removing the incentive to grow timber. Taxes on timber and timberland are fast becoming confiscatory, and indeed in many counties in Georgia they already are too high for economical timber growing.

2. Timber stand improvement is not something most landowners become actively involved with, such as prescribed burning, and cull tree injection. Therefore the active and passive rule concerning expenses for these management items is unfair because probably 95% plus of landowners are passively involved. They hire professional foresters as they should.

3. Georgia is the nations leading state in pulpwood production and in the top five in sawtimber production, leading the southeast in the latter category. The timber industry is Georgia's largest, surpassing textiles years ago.

   The southeastern United States is unique in that we are the "bread basket" of the world in softwood timber growing capacity due to our long growing season and high yearly average rainfall.

4. Trees are natures natural vacuum cleaners and air freshners, taking in carbon dioxide of which man creates a great deal, and giving off oxygen of which we need in vast amounts to sustain life.

5. Georgia is the nation's fifth fastest growing state, therefore our destiny may be to become a service or high tech center, and we may lose our position as number one in timber production in the southeast. But until our schools provide the type people who can entice and supply employees for these new industries, we need to maintain and nurture our timber industry and the timber growers who furnish this vital resource.

   Our world is in trouble because of the loss of our ozone layer, air pollution which is already killing the forest over much of Europe and much of the areas in Africa and South America where the forest land is being depleted at an alarming rate. Forest and forest land are needed desperately to sustain mankinds quality of life.

GREGORY AFFILIATES, INC.

WRITTEN STATEMENT OF WILLIAM H. GREGORY
PRESIDENT
GREGORY AFFILIATES, INC.

HEARING ON TAX ISSUES AFFECTING THE TIMBER INDUSTRY
CONDUCTED BY
THE SENATE SUBCOMMITTEE ON CONSERVATION & FORESTRY

MACON, GEORGIA

MARCH 13, 1989

4800 S.W. GRIFFITH DRIVE BEAVERTON, OREGON 97005-2987 (503) 644-8004

My name is Bill Gregory, and I am President of Gregory Affiliates, Inc. I want to thank Chairman Fowler and the subcommittee for providing me this opportunity to address the subject of tax issues affecting the timber industry.

I am especially grateful for the opportunity to draw the subcommittee's attention to how Foreign Sales Corporations ("FSCs") provide tax advantages to exporters of raw logs. In light of the acute timber supply shortage in the Pacific Northwest, and legislation pending before Congress to prohibit or substantially curtail exports of raw logs from public lands, tax incentives for the export of raw logs is counterproductive and poor public policy. Before describing my concerns with the tax advantages available to log exporters in greater detail, let me provide some background on Gregory Affiliates.

Gregory Affiliates owns three subsidiaries: Gregory Timber Resources, Northwest Timber Affiliates, and Gregory Forest Products ("GFP"). Gregory Timber Resources and Northwest Timber Affiliates are organized for the purpose of bidding on and harvesting timber-sale contracts. GFP is organized to operate mills and sell lumber and is by far the most significant of the Gregory Affiliates' subsidiaries. The operations of GFP are primarily in Glendale, Oregon where we operate a saw mill and plywood and veneer plants. GFP also operates a veneer plant in Klamath Falls, Oregon.

GFP's mills in Glendale produce on an annual basis 82 mmbf of lumber, 210 million square feet of plywood and 140 million square feet of veneer. In addition, its Klamath Falls veneer plant produces approximately 132 million square feet of veneer each year. To put this production in perspective, the monthly output of GFP's plywood mill, if the plywood boards were stacked on top of each other, would reach an altitude of 3 1/2 miles.

GFP employs approximately 480 full time workers with an annual payroll of approximately $16.7 million. It also employs outside contractors to log its timber sales, which involves an additional annual payroll of approximately $5 million.

GFP depends almost totally on timber from lands administered by the Forest Service and Bureau of Land Management ("BLM") to meet its annual timber supply needs of approximately 100 million board feet of timber. Like many timber companies in the Northwest, GFP owns no fee timber lands.

Unfortunately, the supply of timber from Forest Service and BLM lands is increasingly uncertain and may decline significantly due to the promulgation of new land management plans by those agencies and environmental appeals and litigation. Recently issued injunctions have precluded the harvest of approximately one billion board feet of timber in Oregon and Washington. GFP has already laid off 50 workers due

to the timber supply shortage, and numerous forest products mills have closed down entirely. Over 10,000 workers in Oregon alone may lose their jobs unless the injunctions are lifted or alternative supply sources are found.

Ironically, at a time when Northwest mills are closing for lack of logs, nearly 4 billion board feet of timber was exported from Oregon and Washington in 1988. Mill owners who cannot obtain adequate timber supply to keep their mills running, and workers who have been laid off, are understandably concerned about the export of jobs and wood processing profits each time a ship carrying raw logs sets sail from a Northwest harbor. This concern has led Senator Packwood, Congressmen DeFazio and AuCoin and other members of Congress to introduce or support limitations on the export of logs harvested from state and federal lands. Others have suggested imposing a surcharge or other fee on raw log exports.

Given the current controversy surrounding log exports, you can imagine my concern about the federal tax subsidies available to log exporters. As noted above, this advantage is provided through FSCs.

A taxpayer may use a FSC to reduce its U.S. taxes on its export profits in the following manner. The taxpayer pays a portion of its export profits to a wholly owned FSC as a deductible commission. A portion of the commission is tax-exempt for the FSC. The FSC then returns the commission to the taxpayer as a tax-exempt divided. The end result for a

taxpayer using a FSC is an effective reduction in the tax rate on part of its export profits. In a typical case, the reduction in the tax rate may be about five percentage points. Accordingly, companies that export qualified products have a competitive advantage over those that do not.

FSCs provide this advantage for the export of all qualified "export property". Certain property is specifically excluded from qualifying as export property. Excluded property includes oil and gas, products the export of which is controlled under the Export Administration Act of 1979, and products determined to be in short supply by the President and designated as such by an Executive order. Raw logs are apparently not excluded property under current law.

The attractiveness of FSCs for log exporters was further enhanced by the Technical and Miscellaneous Revenue Act of 1988, which allowed each separate account maintained by a "shared FSC" to be treated as a separate corporation for income tax purposes. A shared FSC is any foreign sales corporation that maintains a separate account for transactions with each shareholder (and persons related to such shareholder) that bases its distributions to each shareholder on the amounts in the separate account maintained with respect to each shareholder and meets other prescribed requirements. The effect of this change is that small log exporting companies that otherwise would not bother to set up a FSC are encouraged to band together to take advantage of the tax benefits a FSC

provides. In other words, the 1988 Act exacerbated an already unhealthy trend towards Internal Revenue Code encouragement of log exports.

In light of the serious problems posed to the stability of the Northwest's forest products industry by log exports, Gregory Affiliates respectfully requests that this subcommittee work with the Finance Committee and others in the Congress to exclude raw logs from the definition of "export property" qualifying under IRC § 927(a) for a FSC tax advantage.

This concludes my statement. I would be pleased to answer any questions you may have.

March 13, 1989

Honorable Wyche Fowler
Congress of the United States
U. S. Senate
Washington, D. C. 20515

Dear Senator Fowler:

I am a forest landowner in Georgia and need your help in changing the 1986 Tax Reform Act as it pertains to timber growers. I represent that segment of the timber industry that comprises the majority of forest ownership in our state and throughout the South - the non-industrial forest landowners. We together represent approximately 65% of all forest ownership in the region and this is where the timber growth must come from, if we are to meet the demands for timber, pulp, fiber and fuel in the next century. Therefore, we must have incentives to stimulate our participation in the timber industry because it takes a long time for timber to generate income. In particular, the deduction of yearly operating expenses prior to harvesting by non-industrial timber growers and the special capital gains rate must be re-instated or we shall be forced out of the timber business, and the economic welfare of our state will suffer tremendously.

Thank you for your consideration in this matter.

Sincerely,

Betty Bivins Edwards

Betty Bivins Edwards
656 Forest Hill Road
Macon, Georgia 31210

PROCTER & GAMBLE CELLULOSE

STATEMENT TO SENATE COMMITTEE STUDYING FOREST TAXATION
MARCH 13, 1989

My name is Larry Walker. I am a registered forester, and I represent the Procter & Gamble Cellulose Co. Our company owns and operates pulp plants in Oglethorpe, Georgia and Perry, Florida, and a lumber plant in Barnesville, Georgia. These plants represent an investment of close to $500MM. We employ close to 2000 people directly, and I estimate that another 3000 jobs are a direct result of our presence in Georgia and Florida.

These plants use approximately 4.0MM tons of Southern Yellow Pine timber annually, and over half of that consumption is purchased from private non-industrial landowners. Because of our dependency upon private landowners, we are concerned about the growing trend toward harvesting without reforestation by this segment of society. I will not attempt to restate the statistics that reveal this alarming trend, nor will I attempt to provide specific economic assumptions, but I will provide our perspective about the long term impacts of these concerns.

The Conservation Reserve federal subsidy to farmers has masked this problem for the past few years, but as marginal cropland available for planting trees decreases, total reforestation is beginning to drop off tremendously. Without an immediate change in this trend, the forest industry in our area will not be able to support as many jobs in 20-30 years as it currently does because the natural resource will not be here for our children to utilize as we have. Unfavorable tax treatment of timber sale revenue and reforestation expenses along with Georgia's punitive ad valorem taxes have been major contributors to this decline.

The forest industry is one of America's leaders in export revenue and therefore in helping our national trade imbalance. However, many other nations with weather climates that support faster growing trees, lax environmental standards, cheap labor, and favorable tax situations are fast eroding our competitive position. Normally, the basic laws of economics that are causing judicious landowners to let their harvested acres revert to scrub waste lands should work to cause a supply and demand situation that would raise prices and solve the problem. However, due to discouraging tax treatments of forestry investments and foreign competition in the pulp market, economic investment in reforestation is not happening as it should.

To turn this alarming trend around, to provide jobs and a healthy environment, and to support one of the few American industries that helps our trade imbalance, I urge you to modify our tax laws to provide capital gains rates for timber sales and to provide for annual expensing of the costs of reforestation and land management that have to be carried over the length of a forest crop rotation.

I appreciate the opportunity to provide this input, and I thank you for your consideration of these comments.

Post Office Box 38
Pine Mountain, Georgia 31822-0038
March 13, 1989

Senator Wyche Fowler, D-Ga.
Senator David Pryor, D-Ark.

Senators:

1. My name is Henry A. Mullins. Senator Fowler will recognize Pine Mountain as being the mailing address for Franklin D. Roosevelt State Park and for Callaway Gardens.

2. I appreciate the opportunity to attend this hearing on how the 1986 Income Tax Code has affected the timber industry and what the restoration of the capital gains exclusion would mean to producers.

3. In my opinion, I am a typical SMALL producer. For as long as I can remember my family has been selling timber and pulpwood every 12-14 years. The last wood we sold was 15 years ago. Mrs. Mullins and I decided to hold the wood a little longer this time and use the money to supplement our retirement income. The 1986 Tax Code will reduce this income from wood by a considerable amount.

4. I am grateful for the committee's interest and hope your efforts will restore the capital gains exclusions.

Henry A. Mullins

Honorable Wyche Fowler, Jr.
United States Senator
Senate Office Building
Washington,D.C. 20510

We, the undersigned petitioners, request that Senator Wyche Fowler support legislation to reinstate the capital gains deduction for all capital gains including timber sales and cattle sales.

NAME	ADDRESS
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N.E. Newberry	Lizella Ga 31052
Edward Newberry	Box 4910 Lizella Ga 31052
Nolan. E Hutcheson	Box 4910 RT 2 Dixon
Henry D. Bryant	Lizella Ga 31052
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B.F. Newberry Sr	Lizella Ga Rt 2, 31052
M C Newberry	
MC Muncey Jr	5095 DIXON RD LIZELLA GA 31052

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Frank V Byrd	Lizella Ga 5445
Randall V. B	4704 Rogers Rd Lizella GA
Larry L Bak	Rt. 2 Box 532
	Byron Ga 31008
C. Ellen Newberry	CMR #2 Box 12318
	Ft. Rucker, Ala. 36362

NATIONAL ASSOCIATION OF STATE FORESTERS

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202/624-5415
Suite 526
Hall of the States
444 N. Capitol St., NW
Washington, D.C.
20001

For the Hearing Record
March 13, 1989
Testimony on Tax Issues Affecting
the Timber Industry Before the
Senate Agriculture Subcommittee on
Conservation and Forestry
Macon, GA
by John Cashwell
State Forester of Maine
National Association of State Foresters

I am the State Forester of the State of Maine. In that capacity I am a member of the National Association of State Foresters (NASF) and Chair the of the Forest Resource Management committee.

The NASF has been greatly concerned about two changes which occurred when the Tax Reform Act of 1986 was passed. These are the infliction of the unfair, short sighted and restrictive passive loss rules on the 8 million private woodlot owners of the United States, and the elimination of the capital gains differential. Enclosed please find a resolution passed unanimously by the NASF at its National meeting last fall.

Both of these changes fly in the face of common sense when applied to the woodlot owners of America. This is a time when the nation must engender in any possible way an ethic of stewardship on the land.

While we as a nation demand that our woodlands provide forests to help keep the water clean and the air healthy, to offer shelter and habitat for our wildlife, to provide hunting, fishing and other recreational opportunities, and to maintain a rural timber base for our forest industries, we take away the only tools the woodlot owners have to help offset the up front costs it takes to be stewards of our nations diverse resources.

Passive loss rules applied to forestry deny sweat equity and fair taxation to woodlot owners. The capital gains loss fails to recognize the years of patience needed to keep the land use in forestry. The loss of capital gains reinforces temptation to sell for development in the short term rather than remaining a renewable, reusable resource for the economies of rural America.

We support and applaud the efforts of the "Forestry 2000 Task Force" in their efforts to remove two major obstacles to help the woodlot owners of America in their efforts to remain stewards of the land.

We hope that you consider a Senate version of HR 1086 and set this country's forestry related tax policy back on a positive course for the 8 million woodlot owners across this Nation. If the NASF can assist you in any way please contact us.

NATIONAL ASSOCIATION OF STATE FORESTERS

1988 EXECUTIVE COMMITTEE

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Washington Representative
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RESOLUTION

REPEAL OF IRS PASSIVE LOSS RULES

WHEREAS, productive non-industrial private forests require human attention over decades rather than by the hour; and

WHEREAS, new passive loss tax rules ignore the cyclical and long-term nature of forestry as well as require unrealistic yearly measures of activity; and

WHEREAS, capitol gains tax differential for forestry activities has already been eliminated; and

WHEREAS, new rules further hamper the likelihood of landowner investment on woodlot management; and

WHEREAS, passive loss rules represent a disincentive for woodlot management to eight million private owners who own 58% of America's forests, adding to 257 million acres; and

THEREFORE, BE IT KNOWN that the National Association of State Foresters request that IRS revise its rules on passive loss to reflect the importance and uniqueness of non-industrial private forest management.

Action taken ADOPTED Attest: Robert S. Moss
Robert S. "Sid" Moss, President

September 12, 1988

Witness: Roy Ashley
Roy Ashley, Secretary

NFPA

March 23, 1989

Honorable Wyche Fowler, Jr.
U.S. Senator
Chairman Senate Agriculture Committee's
on Conservation and Forestry
204 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Fowler:

The National Forest Products Association and Forest Industry Committee on Timber Valuation and Taxation were pleased to send members of our staffs to attend the field hearings you conducted in Macon, Georgia on March 13,1989, to determine the impact of the 1986 Tax Reform Act on the timber industry. The Associations had the pleasure of working with your staff during the preparations for the hearings. The Associations concur with the views expressed by the witnesses and wish to take the advantage of your offer to keep the record open for a reasonable period so that written statements can be submitted.

NFPA is a national industry trade association which represents the interests and views of owners and managers of forest lands, manufacturers of forest products, and affiliated regional and product associations. Our membership includes over 500 direct, associated, and allied members in every state. The FICTVT is a national organization of thousands of landowners, ranging in size from the largest, fully-integrated manufacturing firms, to the smallest individual Tree Farmer, who are interested in the taxation of timber.

You can, therefore, understand our keen interest in the subject of the hearings. The short and long-range impact of the repeal of capital gains rates and the unexpected application of the passive activity loss rules are detrimental to tree growers throughout the United States. On behalf of our members in every section of the country where tree growing is an important industry the Associations wish to go on record as endorsing the statements by the witnesses who primarily addressed the impact on Georgia and other Southeast tree growers.

The 1986 Tax Reform Act produced massive changes in the nation's tax laws. These changes were intended to remove, to the extent possible, taxes from the business and investment decision making process. The were also intended to make our income tax system

NATIONAL FOREST PRODUCTS ASSOCIATION
1250 CONNECTICUT AVE. NW • SUITE 200 • WASHINGTON, DC 20036 • 202 463-2700

fairer and simpler. The latter objectives were accomplished for some taxpayers but in other instances the exact opposite occurred, leaving some taxpayers facing inequitable and, in many instances, complex tax laws. It is understandable that Congress, in dealing with a major piece of legislation could not foresee all the possible consequences.

Fallout from repeal of long-term capital gains rates.

The repeal of the capital gains rates differential is likely to have an adverse impact on the nation, but the impact on the tree growers of America, is immediate and severe. In the long range the damage to this essential renewal resource is irreparable.

The 1986 Act didn't just increase the top capital gains rate from 20% (and remember many tree growers in lower tax brackets paid a lower gains rate than that) to 28%, it also increased the effective rate on the true economic income from timber sales to a level substantially higher than the stated ordinary income tax rate of 28%. Trees must be held far longer than any other capital assets before they can be sold for the optimum yield, hence a far larger portion of the gain is inflationary or noneconomic (imaginary) income. By applying the 28% to the total gain, both real and imaginary, the tree grower can easily wind up paying an effective tax rate of 50 to 65%, or even higher, on the economic gain. Special capital gains rates have always been intended to offset the otherwise higher effective tax rate the seller of a capital asset would otherwise have to pay. Of course, special capital gains rates were also intended to compensate for the time value of money. In addition to the risk element, there is the loss of the use of the funds that would otherwise be available if not tied up in the capital asset. Again, as with the inflation element in the gain, the time value of money factor is heightened because of the much longer holding period experienced by tree growers.

Without the capital gains rate differential tree growers simply can no longer make investments in planting and tree growing. The higher effective tax that results when the trees are eventually harvested makes it uneconomical, and perhaps ruinous for tree farmers to invest in good timber management and tree planting. If this situation is left uncorrected consequences to the nation will be dire.

The 1986 Tax Reform Act contains many beneficial features, including reductions in income tax rates for both individuals and corporations. This rate reduction has done much to keep the country's economy flourishing. NFPA believes that raising rates is not necessary or wise on the grounds that is the price to pay for correcting the unfair overtaxation of tree growers.

The fallout from the unexpected application of the anti-tax shelter law.

Tax shelters had reached epidemic portions by 1986 and were seriously eroding the nation's tax base. Reduction in individual tax rates by the 1986 act would likely have caused tax shelter investment to abate. However, Congress felt the situation was bad enough to take more drastic action. The results were the enactment of the passive active loss rules, a major disincentive to invest in tax shelters. This law is retroactive in that the rules apply to existing tax shelter interests already owned by taxpayers. Essentially, it provides that if an individual invests in an active trade or business in which he does not materially participate his distributive share of loss from the activity has a special character. The loss is referred to as a passive activity loss (PAL). The PAL can not be used to offset the individual's other income such as wages, dividends, etc. but can only be used to offset income from the activity or other activities in which the individual does not materially participate. Thus , more often than not, the individual cannot take a current deduction for the PAL, but must hold it in suspense until he can use it against other passive activity income, or until he disposes of his interest in the trade or business

A material participant is defined in the code as a taxpayer who is involved in the activity on a basis which is, (1) regular, (2) continuous, and (3) substantial. The temporary regulations expand on this definition, but primarily use hours worked as a measure of whether there is material participation. Seven situations are posed in the regulations. In most cases, tree owners would have to meet a 500 hours test. That is, they are not material participants unless they devote 500 hour to their tree growing operations. Congress surely did not intend that a tree grower who devoted fewer hours could not deduct his current timber management expenses when they exceed gross income from the operations. For small timber operators there are frequently long intervals between timber harvests, yet good management practices require expenditures in the years between harvests. There is no tax shelter in timber investment. The losses represent hard dollar cash outlays which the tree grower must expend from his other resources. To require him to capitalize these expenditures until he harvests trees, thus denying him the tax benefit from a current deduction , is going to cause him to reduce or halt good timber management practices. The tree farmer simply cannot afford to make nondeductible expenditures, which often must be deferred until many years in future. This is not only disastrous for tree farmers, it bodes ill for future timber supply.

Conclusions.

NFPA and FICTVT laud the objective of the passive activity loss rules and the blow at tax shelters has been good for the country as money formerly invested in tax shelters is going into productive activities. However, like certain therapies used in treating

serious illnesses, there can be serious side effects that are damaging. Fortunately, passive activity loss side effects can be corrected, without detracting from the thrust of the anti-tax shelter measure, through a modest amendment to the law. A bill has been introduced to treat tree farmers as material participants if they make all the significant decisions or do substantially all the work in their timber operations. We urge support for Congressman Wyden's bill (H.R. 1086) and hope that similar corrective legislation will be introduced in the Senate.

The points chosen for discussion in this statement for the record were selected either because witnesses did not cover them or did not fully cover.

Respectfully yours,

Barry Cullen
President
NFPA

William Sellery, Jr.
Executive Director
FICTVT

SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
SUBCOMMITTEE ON CONSERVATION AND FORESTRY

Field Hearing on Tax Issues Affecting the Timber Industry
Monday, March 13, 1989

The revisions in the tax law is destroying the private enterprise system and the farming industry as far as future growth of timber. The wagon is over-loaded and under the present situation there is no profit in growing timber. It is foolish for an individual or industry to plant a tree, when they know they will incur a loss to capital and labor and to their general well being. The profit is nill and they will be paying out ad valorem taxes that they will never get back.

This law is wrong because it is destroying the natural resources of this nation. There has got to be a profit incentive to reforest cut-over timberland. How long America can follow the course of destroying the capitalist system of government is only a matter of conjecture. Trees take 50 years to grow to market maturity. Under this greedy law, the government will not be able to cure this monsterous destruction of the land, the health, and welfare of its' people. In the end, we will reap unemployment, water pollution, soil loss and nutritional value of the land, and self destruction of its' people.

The Tax Reform Act of 1986 changed the long term capital gains income. A good way to explain it is with a story about a farmer and a cow.

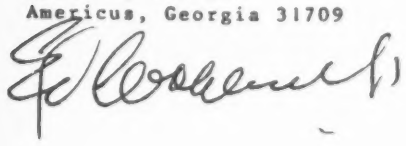
The farmer buys a cow and feeds it. The only way the cow can repay the farmer is with milk and her calf. A law is passed that requires all of the milk to be sent to Washington, D.C. The calf starves. The farmer can no longer afford to feed the cow, she starves. The farmer by then is out of business, he starves.

The capital gains advantage on long term income is the "milk of human kindness".

I have personally been involved in growing timber for 54 years and have seen the forest come and go. I own timberland in Georgia, Florida, and Arkansas. The timberlands that I see as I travel from one state to another across the southern part of the United States, are in the worst state of disruption and regeneration that I have known in my lifetime.

We only ask for the means to properly manage our timberlands. Under the free enterprise system, properly managed business will generate an adequate amount of taxable income without "starving the calf".

Ed Wohlwender
Route 6, Box 236
Americus, Georgia 31709



Southern Forest Products Association
Statement to the
Conservation and Forestry Subcommittee
Senate Agriculture Committee
March 13, 1989 - Public Hearing
Macon, Georgia

The Southern Forest Products Association, an organization of lumber manufacturers in twelve Southern states, has 43 active member companies which account for about two-thirds of the total Southern Pine lumber production. And two-thirds of their raw material comes from nonindustrial private forestland ownership.

Total Southern Pine lumber production in 1988 reached 12.62 Bbf, a level not seen since 1925. Overall, the southern region supplies over 50% of the nation's wood needs with the state of Georgia being the leader in Southern Pine production.

To maintain the South's potential for future timber growth, we must greatly intensify the current level of forest management practices. That, in turn, depends on the inclinations and motivations of private landowners who hold close to 70% of the region's commercial forest acreage.

Strong forestry incentives are needed to first stem and ultimately reverse unfavorable trends. Some of the most important incentives are reinstatement of long-term capital gains treatment

for timber owners and clarification of passive activity loss to allow landowners to deduct forest management expenses on an annual basis.

We must not regress to pre-1944, when the U.S. had less timber at the end of every year than at the start. Due to favorable timber tax treatment, 41 million acres of private lands were planted from 1944 to 1986. The long-term investment and risk involved in timber growing must not be penalized in relation to other investment opportunities or the capital needed for forest management will flow elsewhere.

According to a recent publication entitled "The South's Fourth Forest: Opportunities to Increase the Resource Wealth of the South", 22 million acres of cropland and pasture in the South would be of more value to their owners if lands were planted in pine trees. Conversion of this land to timber production could increase net annual softwood growth by 25.2 billion board feet.

SFPA has traditionally supported favorable tax treatment for timber. We encourage positive action by Congress to provide economical and practical benefits to individuals and companies that will assure that our forests will last forever.

THE PROFESSIONAL VIEW

SOCIETY OF AMERICAN FORESTERS
5400 Grosvenor Lane • Bethesda, Maryland 20814 • (301) 897-8720

STATEMENT OF
E. THOMAS TUCHMANN
DIRECTOR OF RESOURCE POLICY
Before the
INTERNAL REVENUE SERVICE
On
PROPOSED PASSIVE LOSS RULES

JUNE 28, 1988

My name is E. Thomas Tuchmann. I am the Director of Resource Policy for the Society of American Foresters (SAF). The Society is the scientific and educational association representing all segments of the forestry profession, including public and private forestry practitioners, researchers, administrators, educators, and students.

Today I appear before you on behalf of SAF's 20,000 members who are concerned with the proposed passive loss criteria for the determination of an investor's material participation in an activity. As currently constituted, these criteria may discourage landowners from investing in long-term forest management, which may possibly lead to decreased timber production, liquidation of timber inventories, and adverse environmental impacts. We will touch on five areas of concern: (1) the role of nonindustrial private forests; (2) the unique nature of timber management investments relative to other business ventures; (3) the role of forest management in increasing forest productivity and maintaining environmental quality; (4) the potential effect of implementing the proposed rules on responsible, long-term forest management; and (5) how the proposed rules might be modified to address these problems.

Nonindustrial Private Forests

Historically, the United States has looked to the nation's private forests for a substantial portion of its timber needs. Private lands produce 47 percent of the forest products industry's roundwood supplies, and the U.S. Forest Service projects that they will be the largest source of future U.S. wood supply. About 60 percent of the commercially productive forestland in the United States is held by the nation's nearly 8 million nonindustrial private owners. We believe these are important points as growing demands for noncommodity resources on our public forestlands increasingly put pressure on displacing timber production.

Nonindustrial private forestlands provide much more than just wood-derived forest products. Of equal importance are wildlife habitat, a variety of recreation opportunities, and numerous environmental amenities, including water and air quality. Proper management of these lands can maintain or increase the production of all these benefits.

Nature of Timber Management Investment

Investments in private forest management are unique in many respects. These lands must be held for long periods before maturing, are often subjected to substantial risk of loss (caused by fire, insect and disease attack, and severe weather damage), typically have a low degree of liquidity, and may yield rates of return that are low relative to other capital-investment opportunities.

Investment in timber production is not a tax-shelter type of investment, which the passive loss rules are in part intended to discourage. Timber production does not entail typical tax-shelter characteristics such as providing tax benefits within a relatively short period without the requirement of reasonable corresponding expenditures or the assumption of commensurate risks. Rather, timber production provides tax benefits generally based on real out-of-pocket expenses, requires long investment periods before a return is realized, and, again, involves significant biological risk exposure to natural hazards such as fire, insects, disease, and weather-related losses.

Forest Productivity and Environmental Quality

Ensuring forest productivity and environmental protection requires that investments be made periodically throughout the timber growing cycle, not just at the time of harvest. While timber management income is earned primarily at the time of harvest, timber management costs occur periodically throughout the timber growth cycle. Depending on timing, reforestation investment costs may not occur in the same tax year as harvest income was received. Once reforested, through planting or natural regeneration, sites often require costly herbicide, mechanical, or biological treatments to reduce vegetative competition with young seedlings. In order to maximize productivity, many species also require intermediate thinnings before reaching harvest maturity. These thinnings may or may not yield an income to offset management costs. Ongoing management efforts are necessary to monitor, protect against, and control insect, disease, fire, and other threats.

Sound forest management also helps protect and improve the forest environment and its attendant recreational and esthetic values—increasingly important objectives to many landowners as well as to the general public. For example, certain harvesting practices may improve wildlife habitat while others may degrade it. Proper harvesting practices used in the vicinity of streams help to protect fisheries and water quality, while improper management can impair them. Since many state and local governments are tightening their forest practices regulations, landowners are obliged to apply more responsible management practices.

Achieving these objectives often requires use of resource professionals to help prepare management plans or provide advice on alternative management practices. Professional contractors may also have to be hired to thin stands or plant new seedlings after a harvest. Seeking expert advice or hiring contractors to perform on-the-ground labor does not remove the landowner from the role of active manager and decision-maker.

Potential Effects of the Proposed Rules

The proposed passive loss rules could cause many nonindustrial forestland owners to become less interested in managing their forestlands as timber-production investments. The proposed rules could result in the loss of the opportunity to deduct timber management costs greater than timber income from active or other investment income, in the year the costs occur--an opportunity offered to landowners since 1913. Under the proposed rules, such costs would have to be carried forward to future years when timber management income is great enough to fully offset the costs. Elimination of the opportunity to fully deduct costs in the year they occur could have serious consequences for nonindustrial private forestry investment, where a significant management investment might not yield an offsetting return for 20 to 80 years.

As presently constituted, the proposed passive loss rules may discourage landowners from making the periodic and ongoing investments required to ensure forestland productivity. These investments require significant management efforts in some years and less in other years. Such activity--though it represents well-established and accepted forest management practices--may not meet the material participation requirements of the proposed passive loss rules if completed with the assistance of professional forestry consultants or contractors. Forest management activities should not be categorized as passive simply because they may require less investor activity in a given year than other business activities. Decreased forest productivity resulting from reduced timber management investment or, at worst, liquidation of timber stands and a complete halt of further management activity, could have negative impacts on timber supply.

Finally, providing environmental protection is an essential element of sound forestland management. Decreasing the landowners' ability to deduct management costs in the year they occur increases the net costs of forestland management investment. Such a result of the proposed rules will leave landowners with a thinner margin to invest in discretionary management practices which contribute to environmental protection and other noncommodity uses.

Rule Modification

To reiterate, the Society believes the proposed passive loss rules fail to recognize the nature of the landowner activities that comprise active forestland investment. We have enumerated some of the potential undesirable outcomes of this perception. To overcome these problems, we suggest that the material participation criteria be modified to recognize the periodic nature of many of the management activities required for timber production on nonindustrial private forestlands. Criteria should also be changed to allow that professional resource management consultant and service contractor time, dedicated to long-term forest management, be credited to a landowner's material participation account. Modifications to the rules should not impose unduly burdensome record-keeping requirements on landowners.

Conclusion

The Society of American Foresters favors a federal tax system that encourages opportunities for investing in private forestry, enhances the application of

sound forest-management principles, and improves the productivity of the nation's privately owned commercial timberlands. Polices that decrease after-tax returns from long-term forestry investments--such as the proposed passive loss criteria for material participation--will reduce the economic margins of such investments and may lead to environmental degradation and the liquidation of existing private inventories. The Society, therefore, respectfully recommends that the proposed passive loss rules be modified to reflect the concerns we have raised.

Thank you for the opportunity to comment on this matter. Please feel free to contact me for further information or clarification.

Adopted by the Executive Committee of the Society of American foresters on June 28, 1988, in accordance with SAF Bylaw 11-J1(b).

(Federal Tax Treatment of Income From Timber Investments--a position of the Society of American Foresters follows:)

THE PROFESSIONAL VIEW

SOCIETY OF AMERICAN FORESTERS
5400 Grosvenor Lane • Bethesda, Maryland 20814 • (301) 897-8720

FEDERAL TAX TREATMENT OF INCOME FROM TIMBER INVESTMENTS

A Position of the Society of American Foresters*

The Society of American Foresters supports policies that encourage sustained investments in forest management. Income tax policies at the federal level that influence private forest management include capital gains treatment of income from the sale and harvest of timber, the deductibility of certain timber-management costs, and the short-term amortization and tax credit for reforestation and related stand-establishment costs. Failure to maintain federal tax policies of this nature would discourage private investment in the production of timber and may lead to discrimination against timber investments relative to other business-investment opportunities.

Need to Encourage Investment in Private Forestry

Historically, the United States has looked to the nation's private forests for a substantial portion of its timber needs. This will continue to be the case as we depend on second-growth forests established and maintained by direct private investments. Investments in private forest management are unique in many respects. They must be held for long periods of time, are often subject to substantial risk, typically have a low degree of liquidity, and may yield rates of return that are low relative to other capital-investment opportunities. Investment in timber production is a long-term investment in a natural resource, which provides for jobs and tax revenues. These investments will significantly add to the economic and social welfare of the nation. Given these circumstances, the Society of American Foresters favors a federal income tax system that rewards investments in timber and enables stability of private forestland ownership.

Major Federal Income Tax Provisions

Capital gains treatment of timber income

Taxing timber income as a long-term captial gain has enhanced investments in timber and encouraged long-term capital growth. It has provided some compensation for the long time periods and the often substantial risks (e.g., insects, disease, fire) that are associated with such investments. Capital gains treatment of timber income is essential to private timberland owners (corporate and noncorporate) who represent the very core of the nation's

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*Adopted by the Council of the Society of American Foresters, April 21, 1986. A position of the Society of American Foresters expires three years after the date of its adoption unless, after thorough review, its continuance is approved.

producers of timber, and on whom the nation must rely for an ever-growing portion of its future timber needs. Changes in federal tax policy should not adversely affect forest landowners who manage timberlands most intensively.

Deductibility of timber-management costs

Deducting the costs of timber-management activities, including silvicultural practices, forest protection, maintenance activities--including property taxes and interest on borrowed money--affords timberland owners equal treatment with investors in other capital assets and income-producing activities. Such tax treatment encourages investments in timber-management activities. Elimination of the opportunity to deduct these timber management costs would have serious consequences for private forest investment, including inability to recover ongoing management costs until timber is harvested many years in the future; unique discrimination against timber investments in favor of nontimber investments where most management costs, including interest, are deductible; and imposition on timber investors of an expensive and time-consuming record-keeping system over the life of the timber stand. Poorly designed changes in deductibility rules could encourage timberland owners to liquidate existing timber holdings and discourage future investments in timber production.

Amortization and tax credit

Amortization of annual reforestation and related stand-establishment costs, and allowance of an investment tax credit for a portion of such expenditures, is especially important to nonindustrial private owners of small forest properties--who in the United States number in the millions. Existing federal tax provisions for reforestation have been an especially important source of investment capital for such owners. Elimination of amortization and credit provisions of federal law would impede the flow of investment capital required by nonindustrial private timberland owners to carry out reforestation activities that follow timber harvest.

The Society of American Foresters favors a federal tax system that encourages opportunities for investing in private forestry, enhances the application of sound forest-management principles, and improves the productivity of the nation's privately owned commercial timberlands. Capital gains treatment of timber income, deductibility of timber-management costs, and amortization and tax credits for reforestation and related stand-establishment costs are valuable provisions to corporate and individual private owners of forestland and should be part of such a tax system.

Modification of Existing Tax Policies

Changes in the federal income tax system, especially as they may affect long-term investments as strategic to society as private forestry, should be approached with great care. Changes made should be accomplished only after careful study clearly demonstrates how they are in the public's long-term interest. Although other tax systems may encourage investments in timber management as effectively as the current system, thus far there is no basis for concluding this to be so, or for adopting possible alternatives.

Because of the long-term commitments that private investors must make when financing timber-production activities, the nation is well served by a stable system of tax policies that enables the flow of financial resources to the accumulation of timber as a capital resource. Any decreases in after-tax returns in long-term forestry investments will reduce the economic margins of such investments and in all likelihood encourage liquidation of existing private timber inventories and generally favor nontimber investment alternatives.

All major industrial nations with market economies offer incentives to investors in the production of timber. These provisions have provided such nations with considerable stability and continuity in the management of their timberlands. Changes in federal tax policies should not adversely affect U.S. private timber investors who are often in direct competition with such nations for access to overseas markets for timber products.

In sum, the Society of American Foresters encourages federal income tax policies that enhance the growth of timber as a captial resource. This implies the implementation of policies that are equitable, simple to administer, and have a history of efficiency and effectiveness. Such policies will encourage the application of sound, professionally prescribed forest-management principles and will contribute to the future supply of timber that will be required by the nation in the years ahead.

ABOUT THE SOCIETY

The Society of American Foresters, with about 19,000 members, is the national organization representing all segments of the forestry profession of the United States including public and private practitioners, researchers, administrators, educators, and forestry students

Objectives of the Society are to advance the science, technology, education, and practices of professional forestry in America and to use the knowledge and skills of the profession to benefit society.

Gifford Pinchot and six other pioneer foresters established the Society in 1900.

Members subscribe to a code of professional ethics. The Society is the accreditation authority for professional forestry education in the United States. Its periodicals are the Journal of Forestry, Forest Science, Southern Journal of Applied Forestry, and Proceedings of the SAF national convention.

For more information, contact the Director of Resource Policy

SOCIETY OF AMERICAN FORESTERS
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SENATE COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
SUBCOMMITTEE ON CONSERVATION AND FORESTRY

Field Hearing on Tax Issues Affecting the Timber Industry
Monday, March 13, 1989

The Lower Chattahoochee River Soil and Water Conservation District considered the capital gains changes in the Tax Reform Act of 1986 important enough to give it a high priorty position in its 1989 Annual Plan of Work.

On page two, part IV, under Legislative, item six, the Plan of Work states:

"The Tax Reform Act of 1986 abolished the provision allowing timber sales to be taxed as capital gains. The allowance of capital gains on these sales is one of the best possible incentives for encouraging tree planting and good forest management.

It is recommended that Supervisors of the district call on the Georgia Congressional Delegation in Washington, D.C. at an appropriate time in 1989 and express their views on capital gains, as well as, other legislative needs of the district."

Thank you, Senator Fowler, for providing the appropriate time

The much needed funds to replant and restore the forest resources, after timber is sold, is now being sent to Washington, D.C. in the form of taxes.

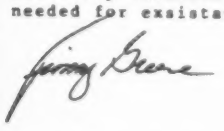
Taxing the sale of forest products as ordinary income is a devastating blow to the industry. Probably the greatest enviromental catastrophy since King Soloman had his temple built.

As you remember, the cedars of Lebanon were ordered to be cut, a tax to build the temple. This act destroyed the semi-tropical ecosystem known to the area in Biblical times. Today this area is a semi-arid desert never to return to its original state. All because of a tax levy on timber.

We must restore the capital gains structure for the sale of timber and other long term gain income to its original status before the revisions were made in 1986.

Some have classified long term gain on timber sales as a tax shelter. The only shelter involved in the long term process of growing a forest is the shade from the beautiful canopied trees. The canopy that filters the air, protects the soil and water, and shelters the rest of God's creation.

Please help restore the capital gains tax incentives to maintain the necessary hardwood and evergreen pine forest that provide a balance needed for exsistance on this planet.



Jimmy Greene
Route 1, Box 64
Americus, Georgia 31709

(Attachment follws:)

Lower Chattahoochee River Soil And Water Conservation District

CLAY COUNTY
LEE COUNTY
QUITMAN COUNTY
RANDOLPH COUNTY
SCHLEY COUNTY
STEWART COUNTY
SUMTER COUNTY
TERRELL COUNTY
WEBSTER COUNTY

LOWER CHATTAHOOCHEE RIVER
SOIL AND WATER CONSERVATION DISTRICT
OBJECTIVES AND GOALS
1989 ANNUAL PLAN OF WORK

The Lower Chattahoochee River Soil and Water Conservation District Board of Supervisors adopts the following goals established by the U.S. Department of Agriculture Soil Conservation Service.

CODE	PRACTICE	GOALS
102	Individuals and Groups Assisted	1,865 No.
106	Individuals and Groups Applying Practices	371 No.
108	Resource Management Systems Planned	15,707 Ac.
329	Conservation Tillage	14,020 Ac.
412	Waterways	6 Ac.
512	Pasture and Hayland Planted	872 Ac.
600	Terraces	64,408 Ft.
612	Trees Planted	7,024 Ac.
173	Approved Conservation Plans	261 No./14,105 Ac.

DISTRICT ACTIVITIES

I. YOUTH AND EDUCATION

The goal shall be to help create a sense of responsibility for conservation of natrual resources in young people. Supervisors should acquaint themselves with the many programs and policies extended to the public through the USDA and the Department of Interior, and assist in the implementation of these programs by attending educational meetings and sharing the supervisors expertise with the public.

1. Develop methods for selecting and encouraging student participation in the Natural Resources Conservation Workshop. Supervisors may use their influence to secure sponsors for those students selected to attend the workshop.

2. Work with public and private school superintendents and curriculum advisors to provide basic information on district programs and to teach conservation and environmental education in the classrooms.

II. FINANCE

1. Pay GACDS dues and make a contribution to NACD Quota Assessment.

2. Develop an appropriate financial plan for the most efficient method of utilizing state funds allocated to the district.

III. FORESTRY

1. To help promote the district program, enter into a Memorandum of Understanding with cooperating government agencies to provide additional services.

2. The district should, when possible, work with the Georgia Forestry Commission to help develop technical plans for timber harvesting and tree planting on fragile sites.

3. Studies should be made and regulations should be implimented to halt the currently used forestry practice of clear-cutting and burning with the use of aerial ignition devices. This type of timber harvest and management is devastating to highly erodible sites, and the use of summer fires ignited by helitorch destroys the reproductive habitat of wildlife species on the area.

IV. LEGISLATIVE

1. Continue to plan and conduct activities to inform city, county, state, and federal officials about the district's programs.

2. Supervisors should contact individual state representatives from counties in the district and inform them of the district's support for the State Commission Technician's program.

3. Inform the public and district boards of developments in underground and surface water legislation relating to agricultural uses.

4. Support and participate in GACDS Legislative Breakfast.

5. The top priority for legislative activity in Georgia should reflect the district's concern for water and water quality. Any new water legislation should protect the public use, but not sacrifice the rights of the individuals.

6. The Tax Reform Act of 1986 abolished the provision allowing timber sales to be taxed as capital gains. The allowance of capital gains on these sales is one of the best possible incentives for encouraging tree planting and good forest managment.

   It is recommended that Supervisors of the district call on the Georgia Congressional Delegation in Washington, D.C. at an appropriate time in 1989 and express their views on capital gains, as well as, other legislative needs of the district.

V. PROMOTION

1. Continue to co-sponsor the Conservationist of the Year Awards program.

2. Distribute and promote the use of Soil Stewardship Week materials.

3. Due to the shortage of adequate funding, supervisors should use influence in local cities and counties for free publicity with local media in carrying through with conservation articles informing the public about district activities.

4. Continue to prepare an exhibit for the Chattahoochee Valley Fair and Exhibition.

VI. RESEARCH

1. Continue to provide and support programs of soil and water conservation research.

2. Promote the activities for developmetn of new cover crops, pasture grass, field crops, trees and shrubs at the plant materials center in Americus, Georgia.

3. The Southern Pine Beetle continues to be the number one threat to timber production in the Southern United States. Active research programs to control this pest are underway, however, success still seems far away. In cooperation with the GACDS Forestry Committee, Supervisors are asked to become more aware of this problem in each county. So far, salvage and removal of infected trees seems to be the best control for the outbreaks of Southern Pine Beetle. Supervisors can help by encouraging immediate salvage of these infested areas.

VII. SOIL EROSION

1. Assist landowners and landusers in developing plans of compliance for the 1986 Food Security Act.

2. Help inform and promote the education of farm related activities in the "Sodbuster", "Swampbuster" provisions of the 1986 Food Security Act.

3. Review all plans submitted that comply with the Erosion and Sedimentation Control Act of 1975. Encourage adoption of Sediment and Erosion Control Ordinances in all counties.

VIII. LAND USE

1. Help to develop management plans for the Conservation Reserve Program (CRP) fields that will maximize soil protection, good forestry practice, and wildlife habitat for the duration of the contract and for the future success of the farm program.

2. Continue to develop land evaluation and site assessment studies for all counties to accommodate development of marginal lands for urban expansion and growth.

3. Encourage final completion and publication of the soil survey reports in all counties.

Statement of Karl Brohammer, Director of Product Services,
Southestern Lumber Manufacturers Association, Inc.,
Forest Park, Georgia
Field Hearing on Tax Issues Affecting the Timber Industry
Macon, Georgia, March 13, 1989

The Southestern Lumber Manufacturers Association, comprising of 365 independently owned and operated lumber manufacturers, support the repeal of the 1986 Tax Act and reinstate the capital gain treatment for timber.

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